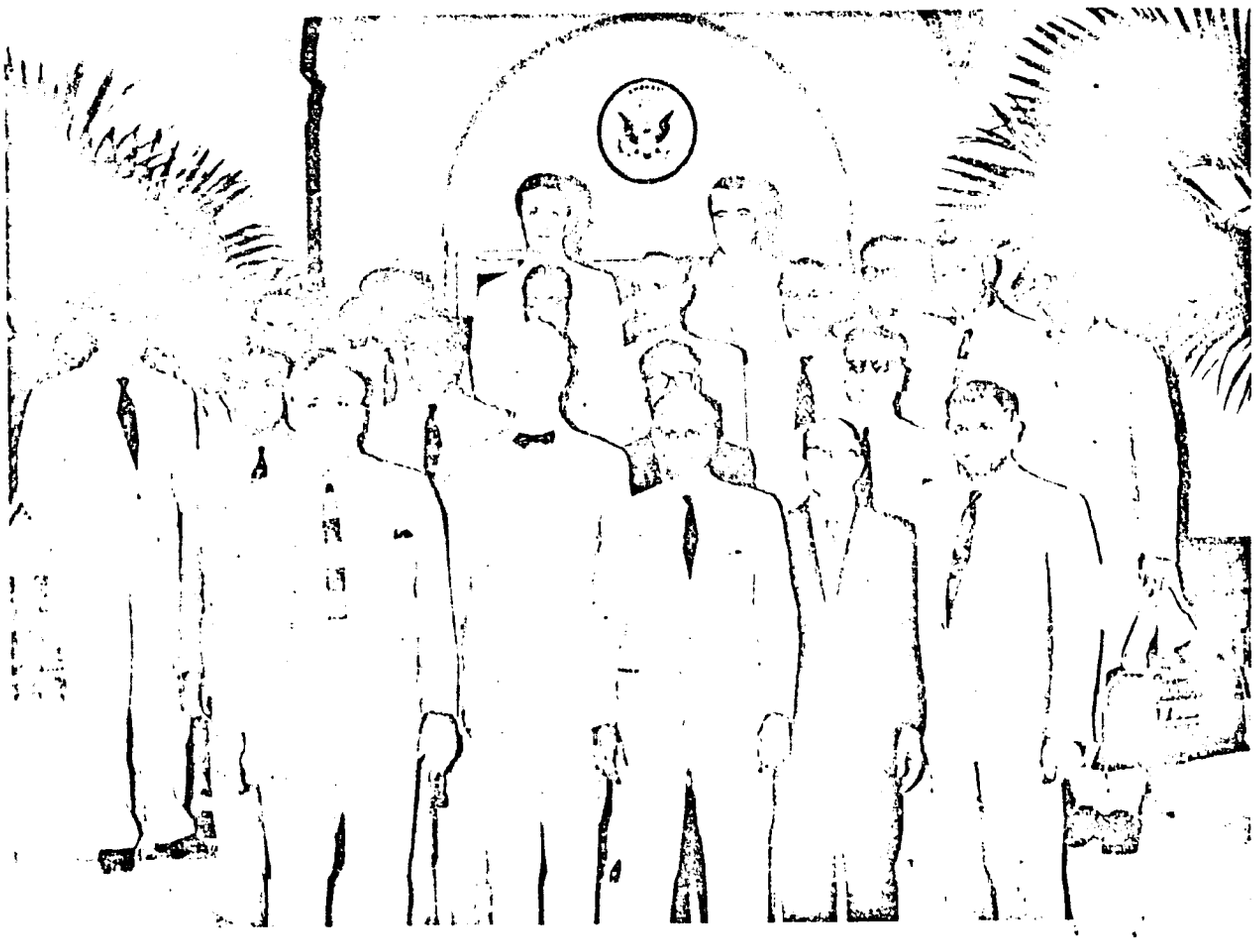
BANKING & INVESTMENT SEMINAR REPORT

APRIL 20-21, 1959
NEW DELHI, INDIA

A summation of observations on United States banking practices made by the sixteen senior bankers representing member-banks of the Refinance Corporation for Industry Private Limited after their three months study tour under the auspices of the U.S. Technical Cooperation Mission to India.

TCM publication



From left
First Row: R.P. Chopra; Ambassador Ellsworth Bunker; T.K. Ramasubramaniam; B.N. Mehta; P.V. Gandhi.

Second Row: V.C. Patel; R.V. Pandit, K.N.R. Ramanujam; M.G. Parikh.

Third Row: S.K. Pandya; S.V. Chandavarkar; Al. Sathappan; Ram Rakha; K.D. Shandilya; K.S. Chaturvedi; C.S. Venkat Rao; G. Anton Burgers; P.K. Sen.

Top Row: I.H. Becker; H.A. Hinderer.

Under the Agricultural Commodity Agreement between the United States and the Government of India signed on August 29, 1956, $55 million in rupee funds were reserved for relending to private enterprise. In this connection it was decided to establish the Refinance Corporation and thereby provide discount facilities to the major Indian banks for medium-term loans to medium-size private industries for the purpose of increasing production.

Generally speaking, Indian banks habitually operate as rather conservative commercial or trading banks. This tradition is preventing these banks from giving maximum support to new and existing industrial ventures. Since the progressive and dynamic practices adopted by most banks in America have contributed considerably to the country's industrial growth, it was felt that a first hand observation of U.S. banking practices might be helpful to the member-banks of the Refinance Corporation. Hence, under auspices of the U.S. Technical Cooperation Mission to India, a three-month visit was arranged in the fall of 1958.

Private banks and also government financial institutions in the United States have shown themselves most gracious hosts and willing to share their ideas and experience with their colleagues in India. On the other hand the group of sixteen highly experienced Indian bankers earned the admiration and respect of their hosts in the U.S. by their keen interest in all phases of American banking.

I N D E X

		Page
1.	Address of welcome by Ambassador Ellsworth Bunker.	3
2.	Address by H. E. Morarji Desai, Finance Minister.	3
3.	Papers presented by the sixteen senior bankers representing member-banks of the Refinance Corporation for Industry Private Limited.	4
4.	Index of Questions.	36
5.	Questions and answers with reference to papers presented by the panel.	37
6.	Report on the operations of the Refinance Corporation for Industry Private Limited by Mr. T.K. Ramasubramaniam, General Manager.	51
7.	Closing remarks by:	
	Mr. Howard E. Houston, Director U.S. Technical Cooperation Mission to India.	53
	Mr. T.K. Ramasubramaniam, General Manager, Refinance Corporation for Industry Private Ltd.	53
	Mr. S.T. Sadasivan, Member of the Board of Directors of the Refinance Corporation and General Manager of the United Commercial Bank.	53

A P P E N D I X

8.	Program for the two-day Banking & Investment Seminar.	54
9.	List of the sixteen speakers and titles of papers presented by them.	56
10.	List of Official invitees.	57
11.	List of Observers.	59

This report contains many references to Indian currencies and quantities in terms of Rupees, Lakhs and Crores. Their equivalents are as follows:

1 Rupee = $ 0.21
1 Lakh = 100,000
1 Crore = 10 million

THE CONFERENCE

The conference was opened by Mr. Howard E. Houston, Minister - Director of the United States Technical Cooperation Mission to India. Mr. Houston introduced the first speaker, U.S. Ambassador Ellsworth E. Bunker.

Ambassador Bunker welcomed the participants and said he was glad to have the opportunity to meet with them after their visit to the United States where they had an opportunity to observe the U.S. Banking system.

Ambassador Bunker said he was quite well acquainted with "both sides" of the banking system.

"I have been a director of a bank - three banks - in the course of my business career," he said. "I have also been a borrower. I have seen the difficulties of both sides. I know some of the problems, I think, of both sides."

He said his observation had been that there were a great many differences between the way banking is conducted in India and the way in which it has developed in the United States. "One of the principal differences," he said, "is the degree of term credit to which the American banks are accustomed."

"As a borrower," he said, "I have borrowed substantial sums myself for a period of five years or more."

The Ambassador explained the American system whereby two or more banks participate in large-scale loans and observed that American banks often have substantial reserves because they are trustees of pension funds and the money in these funds is available for investment.

"I am delighted that you gentlemen have been able to see something of our banking system, and to meet our bankers and discuss mutual problems," he said, "because it seems to me that here now in India you are obviously engaged in accellerated development programs which will keep on accellerating and in which the banks are going to be called upon to play an increasingly larger role, as they have in the United States."

He also referred to the practice in the U.S. of banks making loans on an individual's "character", and cited instances where such loans had worked out very well.

He pointed out that the largest bank in the U.S., the Bank of America, had always been in favor of loans to small business. He said some ultra conservative bankers had predicted that this policy would lead to trouble for the Bank of America. But, he said, the head of the Bank of America had confidence in the people and in the growth of the Western U.S.A., and the Bank has been enormously successful.

The Ambassador then introduced the Finance Minister of the Government of India, Mr. Morarji Desai.

Speech by His Excellency, The Honorable Mr. Morarji Desai, Finance Minister, Government of India.

I am very glad to be here in your midst even if it be for a very short time because the work that I have got to do is intimately connected with the work that you do, and the effectiveness of the work done by government depends on the effectiveness with which you do your work.

I see that this is called a debriefing seminar. Sometimes one is at sea when things are described in the U.S.A. You had been briefed first and now you are being debriefed. I believe it is a stock-taking seminar. That is how I understand this debriefing. That means if you have been prejudiced in any way those prejudices will be removed today. That is the essential part of the work. For any country in the present day, banking system is very vital, especially in a developing economy like ours. It is very important. As we go on developing, we have to go on playing a greater and greater part in the development program. But the system that we have adopted here is more and more based on the British system on account of the relations that we

have had so long. But more than that there are also circumstances in this country which developed, which created, an air of distrust generally in all the transactions that take place in this country, with the result that security has become the greatest consideration in the work one does, and security and development sometimes do not go together. As a matter of fact too much consideration of security hampers growth and hampers development. In the U.S.A. the considerations on credit revolve round good management and an earning potential, whereas here it revolves round security, with the result that we do not make as much progress as we should make, and therefore this visit of sixteen bankers to Japan and U.S.A. was very important from our point of view.

We are grateful to the Technical Cooperation Mission for arranging this, and for giving them the opportunity to go round and learn a great deal. But this opportunity will have been well utilized if those who have gone there will make an impact on the banking system here and will bring down some changes and will enable banks here to consider character as well as security. But how that can be done is a matter for the banks to decide and to devise, not for me to dictate, or for anybody to dictate as a matter of fact, because security certainly is an essential factor in all transactions of lending and borrowing. I am, therefore, very glad that this Seminar is held where a lot of useful discussions will take place to consider how best we can profit from this system which has great resilience, in U.S.A., also in Japan, and how we can fit it in with our circumstances so that we can advance more quickly than we are advancing today, so that several of our difficulties can be tided over more easily than we are able to do today. I wish I was able to be with you for all the two days and for all the time that you are discussing this matter because it would have been more useful to me than to you as your views are perhaps made up in some way or the other - I being a layman and not being bound by any theories or views - and hearing you all I would perhaps have come to some useful conclusion myself and might have been useful to you in an objective manner. In that case, as it is, I wonder if you will have much consideration for any view that I express to you in this matter of banking. And yet you have got to hear me as I am so placed. But that is no consolation to me. I should like to be here only if it is useful to you to hear me and not otherwise. And, therefore, it is not proper for me also to say anything particular just now without hearing you. But I shall certainly go through all your discussions and profit by it even if I am not able to be present here and to hear you and to profit by the discussions because I set a great store on these discussions. Our banking system requires a change. But that change must be a proper change, an effective change, a useful change, and a change which strengthens the system and not weakens it in any way. Because, if it does not strengthen it is not useful in any way. If it has weakened, it has still worse results. It is, therefore, that I do not hazard any opinion in this matter without weighing all the pros and cons of the situation and of the considerations which govern you and others.

I am glad that I am here just now and to be in your midst even for a few minutes because as I told you I attach the greatest importance to it and it is in order to emphasise that importance that I am here. I am thankful to the Chairman and to His Excellency for enabling me to come here and I must apologize for going away so quickly and for not being able to be with you for a longer time as I should have wished, and perhaps you would have also liked.

Thank you.

Mr. Houston thanked the Finance Minister and the Ambassador and then listed the objectives of the Seminar as follows:

1. To explain United States banking operations as you see them.
2. To evaluate U.S. banking practices in the light of those presently followed by Indian banks.
3. To voice suggestions on new thoughts and ideas developed as a result of the study tour for further consideration and possible application in India.

Mr. Houston then presented the speakers, who delivered the following papers.

THE PHILOSOPHY, BASED ON CHANGE IN OUR MODERN ECONOMY, WHICH HAS LED TO THE SWITCH FROM PURELY COMMERCIAL CREDIT BANKING TO INDUSTRIAL DEVELOPMENT BANKING

BY:

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Until the turn of this century, U.S. commercial banking was generally based in its lending aspect on the British banking system; bank loans were generally confined to short-term financing of production and movement of goods. As the sale proceeds of the relevant goods were used to repay the loans, such short-term credit (including commercial paper for ninety days) was deemed self-liquidating in nature and was considered the only appropriate outlet for bank funds from the point of view of liquidity. However, the large credit requirements of a rapidly expanding economy of the U.S. and the varying needs of different types of borrowers led to frequent departures from the traditional short-term loans; they related mainly to commercial loans to individuals, loans against cash surrender value of insurance policies used for carrying stocks or bonds, credit to farmers in the rural areas and real estate loans in urban areas. In addition, certain commercial loans, particularly to industrial units, which were represented by ninety days' paper were regularly renewed so that in effect they became medium-term loans. Thus, the policies and techniques of U.S. banks developed along new lines which served the special financial needs of the communities in which they are located.

The capacity for adaptation of new techniques by the U.S. banks was particularly illustrated in their increasing practice to invest in the bonds of corporate enterprises and also to accept them as collateral for their loans. Thus, at a time when the bulk of economic activity was undertaken largely by a number of successful corporate concerns, the long-term credit requirements of the latter came to be met partly through the banks' bonds portfolios and through collateral loans of commercial bank borrowers, temporarily or for a considerable period. Such bond portfolios of banks do not represent an extension of credit in accordance with the traditional concept of liquidity; the bonds have customarily to be liquidated by sale or shift to other holders. Thus, assets of this kind became liquid through being shifted to other holders and in particular to the Federal Reserve Banks which were required by the Banking Act of 1935 to extend credit to member banks against "any acceptable assets". The old traditional theory of liquidity based on short maturities was no longer the only basis upon which banks were induced to extend credit; the soundness of assets and their acceptability to the Federal Reserve Banks constituted new standards of liquidity, on the basis of which bank assets can now be shifted to the Federal Reserve Banks. It is this extension of the philosophy of liquidity which harnessed bank credit increasingly in the service of industry.

A further extension of the theory of liquidity was rendered possible through the growing volume of formal term loans (those which run for periods beyond one year and in exceptional cases, upto five years) which became an integral part of the lending operations of banks since the thirties. Several special features in the U.S. financial and economic systems contributed to the introduction and development of term loans. The depression in the early thirties, involving a cumulative decline in economic activity, led to the accumulation of cash with banks; their excess reserves were for a number of years at an exceptionally high level. The demand for short-term commercial loans tended to fall, mainly as a result of the phenomenal recourse to stock and bond issues by innumerable corporate concerns to take advantage of the low structure of interest rates. At the same time, there was a significant rise in the volume of investment of bank funds in government securities which was also accompanied by a switch from long and medium-term to short-term securities, resulting generally in a greater liquidity of investments. As a result of the shift in the composition of both loans and investments of banks, their total earnings tended to decline during this period. These circumstances provided a climate favourable to banks in seeking term loans involving a higher yield and increased profits without any further addition to their deposit resources.

This trend was further augmented by other developments also. Perhaps the most important one was the provision in the Banking Act 1935 empowering the Federal Reserve Banks to lend to member banks against long-term notes in times of emergency. This major change in Federal Reserve policy was evident from the discussions in the Report of Mr. Steagall of the Committee on Banking and Currency to the House of Representatives. This report stated:

"This amendment will also make it possible for banks, without relaxing prudence or care, to meet local needs both for short-term and for long-term funds, and to be assured that in case of need they can obtain advances from the Reserve Banks on the basis of all their sound assets, regardless of their form or of the nature of the collateral. Soundness of assets (a term which is here for the first time introduced into the Federal Reserve Act) is a greater safeguard to the banks than short maturity of loans or the particular form of the underlying transaction".

In consonance with the modification of Federal Reserve lending policy, there was also a corresponding change in the attitude of bank examiners, who used to classify previously loans, not liquidated annually, under three categories; slow, doubtful and loss. This method of classification of bank loans was given up by 1938 and since then loans were appraised upon such factors as (1) the reasonable certainty of repayment in accordance with a prepared schedule and (2) the assurance that the loans were adequately protected by earnings, assets or collateral.

Above all, it was the establishment of the Federal Deposits Insurance Corporation in 1934, providing for insurance of deposits of members of the Corporation, which made the general climate more congenial to the practice. As a result of the insurance of deposits, the tendency to large and unanticipated withdrawals of deposits, which had been the characteristic feature of commercial banking in the earlier period, was considerably mitigated. This led to increased stability of individual and business deposits of all banks. The belief that the deposits were subjected to lesser fluctuations was a major factor in inducing banks to look with favour on long-term.

Thus, a combination of several favourable factors contributed to the build-up of term loans, which have generally constituted about a third of total loans of U.S. banks in the last two decades or so. How have the banks been reconciled to term loans from the point of view of liquidity? The significant difference between short-term loans and term loans lies in this; while the former are liquidated by the sale of the assets financed, the periodical repayments of the latter are dependent on the earnings of the borrowing units, after the installation of equipment or other production facilities created by the loans are completed. It is, thus, apparent that commercial banks extending term loans have departed from the former patterns of liquidating bank credit; however through these loans, they have brought into the U.S. banking system a new method of bank credit liquidation namely 'the anticipated income theory of liquidity'.

The essential points of similarity between the traditional theories of liquidity and the new theory are thus explained by Herbert V. Prochnow in his book on 'Term Loans':

"The individual banker may rightly assume that in prosperous times a company that is well managed and that has a satisfactory record of past earnings will be able to make its regular payments or principal and interest on a properly made term loan. In periods of depression, he may also rightly assume that the same well-managed and well established company with a satisfactory record of past earnings will be able to make the same provision for payments on a long-term loan that it might make on a short-term loan. A well established company will in all probability have a surplus and reserves for emergencies. Moreover, in arranging a good term loan, the banker makes allowances for the ups and downs of business and does not extend a credit so large that the interest and principal payments require all the earnings of prosperous times. Some margin of protection is always required.

"On the other hand, a short-term loan against inventories in process, for example, also faces the hazard of sharp declines in prices that may result in net losses. The risk of loss is real in this type of loan, but here it is also to be noted that sound loans are not extended to the point where any loss in the conduct of the business would impair the loan and the ability of the business to continue operations. The banker always requires some margin of protection."

"For the individual bank, liquidity of its long-term loans depends in the first instance on the public consumption of the goods and services produced by the bank's term-loan borrowers. Likewise, the liquidity of the individual bank's short-term loans depends in the first instance on the public consumption of the goods and services produced by the bank's short-term borrowers. The public consumption of goods and services is the actual test of whether both short-term and long-term loans will be repaid. The individual bank is also now assured that it can discount both its long-term and its short-term loans at the Federal reserve banks. In the event of a serious economic depression the ultimate liquidity of the bank's loans rests in shiftability to the central bank or, in this country, to the Federal reserve banks."

"From the standpoint of the entire banking system, the successful operation of the anticipated income theory of liquidity depends upon the public consumption of the goods and services produced by the term-loan borrowers. This is no less true of the liquidation of the short-term loans held in the banking system. Liquidation in their entirety of either the long-term loans or the short-term loans in the banking system would be impossible and would precipitate economic disaster. However, both the long-term loans and the short-term loans of the banking system may legally now be shifted to the Federal Reserve System."

"Since both short-term and long-term bank loans can now be shifted to the Federal Reserve System in any emergency, it may be asked what possible limitations there are to bank credit expansion."

"Practically, there are two major types of limitation to the expansion of credit- those set up by the borrower and those set up by the bank. The intelligent borrower will only borrow so long he is reasonably assured of his ability to make the required payments of principal and interest on his loan. The well-managed bank also wishes to be as certain as possible that the borrower's operations will be profitable and that he will be able to retire his loan. The banker desires liquidation by a forced sale of the borrower's property only as a last resort. Concisely stated, the well-managed bank insists equally in its short-term and in its long-term credits that the loans be of good quality. The insistence upon quality is a limitation upon credit expansion that applies regardless of the maturity date of the credit".

What exactly are the implications to India of the U.S. experience of extension of commercial banking to industrial development and also of the theory underlying this change? It needs hardly to be stressed that there is a great diversity between the monetary and banking systems in India and those of the U.S.A. Bank deposits in India are hardly one-third of the total money supply as against three-fourths in the U.S.A.; hence with a large proportion of transactions effected in cash, the role of bank credit is relatively restricted in India, as against its dominant role in the U.S. economy. A wider extension of bank credit in India is closely bound up with more intensive development of the banking habit, which alone can provide an effective basis for expansion of bank deposits. Priority will have to be accorded by the commercial banks in India to measures designed to increase the range of their services and reduce their charge on facilities of internal remittance and collection of outstation cheques. They should also extend their branch net work to strengthen further their deposit base. Similarly, for a diversified extension of credit, there is great need on their part to examine and adopt, to the extent possible, new types of collateral such as Accounts Receivables, assignment of claims to salary and rent, assignment of rights in a Sales Contract etc. and also the system of guarantee.

Bank loans in India too have departed to a certain extent from the traditional canons of short-term liquidity; loans to individuals not in business, loans against stocks and shares, insurance policies, and real estates do not satisfy this criterion; nor do the short-term loans to individual units, which through a process of periodical renewal have in effect become medium term loans. Commercial banks are, however, yet to possess, apart from Government and other trustee securities and usance bills eligible under the Bill Market Scheme, assets of a kind which in a period of crisis can be shifted to the market or to the Reserve Bank. The scheduled banks' investments in bonds of corporate concerns are insignificant. To start with, some of the bigger banks can adopt a policy of purchase, in increasing volume, of the bonds of first class concerns, as also their shares upto a specified portion of their capital, reserves and time liabilities. Similarly, they can also make a beginning in the extension of formal term loans, based on a proper appraisal of the relevant aspects, including the income prospects of the projects to be financed. The primary requisite both in the purchase of bonds and the extension of term loans should indeed be their quality. The quality of such assets can be ensured only if good management and efficiency of operations characterise the functioning of the agricultural, industrial and commercial sectors in the economy. To the extent that the quality of assets is assured, there should be no reason why they should not become acceptable to the Reserve Bank as eligible assets for its lending purposes. The Reserve Bank, in its turn, should be willing to provide liquidity to the banks by enlarging the portfolio of securities eligible as collateral for its lending and also adopt a more progressive attitude in its inspections to the new lending techniques of banks. The practices and techniques of both the scheduled banks on the one hand and the Reserve Bank on the other should change gradually so as to adopt the philosophy behind the theory of shiftability of assets and the anticipated income theory of liquidity. The stimulus for expansion imparted by our Development Plans should provide the necessary scope for this transformation.

BANK PARTICIPATION IN PROMOTION OF PROJECTS FOR REGIONAL INDUSTRIAL DEVELOPMENT

BY

Mr. Ram Rakha
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One of the highlights of the United States banking system is its progressiveness. Great emphasis is laid by the banks on their responsibility towards the community they serve. Whenever in any region a programme is undertaken for development of industries or revival of a dying industry the banks come forward to participate in helping such programmes and make useful contribution in that regard.

2. A few examples showing the manner and the extent to which the American banks participate in promotion of such projects are given hereunder:

(A) In recent years the State of Massachusetts had to face, what may be called, an economic crisis in that the textile industry of the State started losing ground to a southern State which had established new textile mills. This resulted in loss of employment and a sense of insecurity in the economic activities in the State, because the textile industry, apart from being the oldest in the country, was the most important industry of the State. There were also problems of keen competition and inadequacy of resources, particularly for the small business and the marginal enterprises who mostly needed long-term equity capital but were not considered as bankable risk. To meet this situation, some of the prominent local businessmen got together and voluntarily collected funds and initiated efforts at attracting new business to the area; they succeeded in attracting quite a number of small industries from other States, thereby creating about ten thousand new jobs. In this they got substantial financial support from the Massachusetts Development Credit Corporation. This Corporation, which came into being in January 1954, provides funds for working capital, purchase of equipment, real-estates and even long-term equity capital to individuals and corporations.

The part that commercial banks played in this venture was that they became members of the Development Credit Corporation, without buying any shares thereof. The membership is for a period of 5 years at a time during which period the banks undertake to provide funds to the Corporation, on loan basis, for a period of 5 years for amounts not exceeding 2% of their respective share capital and reserves, at an interest of 1/4% over the prime rate for the time being.

(B) The Wyoming Valley in Pennsylvania used to be a prosperous area owing to its rich deposits of Anthracite coal. But with the growing use of electricity for domestic purposes in place of gas or coal, demand for this type of coal started falling off, collieries began to close down and the economy of this region began to deteriorate. In 1953 the local people, with the active support of the local chamber of commerce, formed a fund called the Greater Wilkes-Barre Industrial Fund and started campaign ing for collection of money by way of donations. This organization, working through the Chamber of Commerce, invites new industry to the region by offering, as an inducement, suitable land and buildings on very reasonable terms. In this process, during the last 5/6 years, 26 new industries have been established in this area creating 15,000 new jobs.

All the 7 banks established at Wilkes-Barre joined in this effort and their contribution towards the fund was by way of agreeing to make loans upto a certain amount to new industry that may be attracted to this region by the Greater Wilkes-Barre industrial Fund. The banks, in collaboration with the industrial Development Corporation, provide the necessary preliminary funds needed for the construction of factory buildings (75% of the cost of building being provided by the Industrial Development Corporation against second mortgage and 25% by the local banks against first mortgages). The banks also provide working capital whenever necessary.

(C) In August, 1958, with a view to providing equity capital to the small business, the Small Business Investment Act was passed which provided for organization of Small

Business Investment Corporations by private enterprises either independently or in conjunction with the Government Agency (Small Business Administration); in the latter case the Government not only provides 50% of the capital but also an equal amount by way of loan.

It was noticed that a number of banks had already applied for organising such Corporations as their subsidiaries so that they could, through such subsidiaries, participate in the growth and development of the small business by providing them with long-term equity loans with 20 years maturity.

3. This approach on the part of the US banks may appear, to some, as unorthodox, but it was in the circumstances, quite necessary and timely. Indeed this progressive outlook and bold action on the part of the United States bankers have made them a useful entity in the economic life of the country. The question as to whether or not, and, if so, to what extent, the principles and practices adopted by American bankers for participating in the regional promotional activities can be introduced in India depends upon the extent to which the Indian bankers are prepared to change their present outlook and policies.

4. At the time of the Evaluation Meeting of our Team with Mr. Edward L. Deuse of the International Cooperation Administration, on the 2nd December 1958, a suggestion was made that a team of officials of the Indian Chambers of Commerce should visit the U. S. A. to study the activities of the American chambers in economic and community development. The suggestion merits consideration.

GOVERNMENT FINANCING AGENCIES AND THEIR COOPERATION WITH PRIVATE BANKS

BY

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In the United States, comprehensive financial arrangements exist for assisting different sectors of the U.S. economy. On their part, the U.S. Government have taken steps to ensure that there are no gaps in the financial arrangements. Commercial banks which play a dynamic role in the U.S. economy may not be able to entertain applications for accommodation in cases where their normal credit criteria are not satisfied. Again, there are many under-developed nations in the free world which look to the U.S. for assistance for importing the equipment they require for essential projects such as irrigation, railways or generation of electric power. The U.S. Government have established specific financial institutions, the funds for which are authorised by the Congress so as to fill these gaps. The main financing agencies thus set up are: (i) the Small Business Administration, (ii) the Export-Import Bank and (iii) the Development Loan Fund, which the members of our team visited during the period September 25/ October 5, 1958. I shall now endeavour to put before you very briefly an outline of the functions of these institutions and the distinctive features of their operational methods.

Small Business Administration (SBA)

The SBA has been established in 1953 as a Government agency to provide financial assistance to small business enterprises, increase the participation of small business in Government purchase operations and provide management and technical assistance. This institution grants two types of loans, viz. (i) business loans, and (ii) disaster loans, when credit is not otherwise available to them on reasonable terms. Business loans are made to finance business construction or expansion, or the purchase of equipment, facilities or material; to supply working capital or as may be necessary to ensure a well balanced national economy. Such loans are either given direct or in participation (immediate or deferred) with private lending agencies such as banks. The policy of the SBA is to encourage participation loans, its participation being limited to a maximum of 90%. The extent of participation with banks and other private agencies will be evident from the fact that nearly 70% of the SBA's loans are covered by

participation arrangements. We were given to understand that in many cases, the SBA was not called upon to actually take up the portion representing its interest in the loans. The SBA has also the authority to make "disaster" loans for rehabilitation of businesses or homes damaged or destroyed by storms, floods and similar catastrophes. Apart from giving direct or participation loans, the SBA helps small firms in a number of ways in overcoming management or technical problems. Perhaps this constitutes the most important function of the SBA as in many cases the problem of small units is not so much lack of finance, as it is of securing managerial and technical guidance in their operations.

Export - Import Bank of Washington:

This bank is the principal agency of the U.S. Government engaged in international finance. The bank is intended to supplement and encourage the utilization of private capital in the export and import trade of the United States and in overseas investment generally; it does not compete with private capital. The bank provides direct financing and extends guarantees. It is prepared to consider proposals for the purchase of portions of its portfolio by commercial banks or other private investors. Thus it works also in cooperation with private banks.

Development Loan Fund:

This is a new source of finance for economic development provided in the Mutual Security Act of 1957. Its purpose is to provide financial assistance preferably in respect of projects in the less developed areas which have a great need for capital. The Fund is required to be operated, as a source of last resort, so as not to compete with private investment capital, the Export-Import Bank or the I. B. R. D. and other financing sources. Guarantee of repayment (by governments of the nations in which investments are made) will not necessarily be required. The Fund has proved to be a very valuable source of finance. So far, $800 million appear to have been voted for it since its inception. It is understood that the Fund has agreed to provide $175 million for India. The unique feature of the Fund is that in certain cases, e.g India, it is prepared to accept repayment in the local currency.

Conclusion:

I may be permitted to say in conclusion that the institutions about which I have spoken are illustrative and not exhaustive of what Government has done in this field in the U.S. as there are other institutions such as the Federal Housing Administration and Farm Credit Administration which we were unable to visit during the brief period of our stay in that country.

JOINT LOANS, IN WHICH A NUMBER OF BANKS PARTICIPATE

BY

Mr. V.C.. Patel
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The Central Bank of India Ltd.

One of the noteworthy features of American Banking practices is granting of loans jointly by more than one credit institution. American ideas of credit functions of commercial banks have evolved from the attempts to meet the growing financial requirements of an expanding economy intent upon development of all resources.

Participation loans have been an outcome of this evolving process necessitated in the initial stages by the peculiar banking structure in the U. S. A. Whereas in countries like the U.K. there are numerically only a few banks having branches all over the country, there are about 14,000 banks in the U. S. A. all governed by their respective State laws which vary from State to State. Owing to deep rooted dislike of any mode of concentration of power in any one organization, the U. S. A. banking system has grown into a "dual" system with powers vested in the States as well as in the National Authority. Since each State was keen on maintenance of its autonomy and full regional development, it formulated its own banking regulations involving certain restrictions on opening of branches by Banks. Certain States permit banks to open branches in one city only, certain in a particular county and certain allow branches within the

State. There are about 12,000 banks which are unit banks having no branch at all. This geographical restriction on the expansion of the branch activities has led to an extensive correspondent relationship between banks in different States which in turn has resulted into participation loans where the financial requirements of a large borrower could not be effectively handled by a particular bank. The "dual" system of banking and State restrictions on branches instead of retarding the economic growth, as would have been normally expected, led to exploration of other avenues for meeting the financial needs of the community and has thus provided a flexible system of banking contributing to the maximum regional development by meeting special regional needs. Another legal restriction imposed on all banks, viz. the prohibition of an advance to a single borrower exceeding one tenth of the Capital and Reserves of a bank has also helped in the growth of Participation loans between different banks.

A prospective borrower may have checking accounts with different banks and may desire to give each bank a part of the credit in order to strengthen his relationship with all the banks. Sometimes a large company is located in a small city whose banks are not sufficiently large to cater for all its borrowing requirements. Sometimes a bank may invite another bank to participate in a loan in the hope of developing stronger relationship between banks and opening opportunity for mutual help.

Participation is also resorted to by a bank which desires an opportunity to convert its assets into a more liquid form having regard to its deposits structure and the nature of commitments already made. The opportunity available to banks for borrowing from the Federal Reserve Banks resulting in improved liquidity and the protection afforded by the Federal Deposit Insurance have enabled the banks to grant long term loans to an increasing extent by inviting, if necessary, participation from other credit institutions. The changing nature of demand for bank credit has also encouraged participation loans. Industry has been operating with higher and higher costs and resulting lower profit margins. This has necessitated larger inventories and more accounts receivable involving increase in the size of bank credit. Acquisition of fixed assets has been an important factor in demand for long term loans. Higher taxation has also brought about an indirect increase in bank credit. Since long term lending has got to be regulated by a bank with reference to its capital, surplus, deposit structure, etc., participation has to be arranged with the growing demand for term loans.

Participation may be between banks, a bank and an insurance company and/or a bank and government agency like the Small Business Administration.

Where long term finance is needed, banks make participation arrangement with insurance companies. Because of the nature of their liabilities the latter are much better equipped to accommodate the very long term borrowing needs of industry. If a borrower requires a loan for 15 or 20 years, the need is obviously one which a bank cannot handle. However, in such cases it is possible for the bank of account to handle three to five years maturities leaving the later maturities to the insurance company. Usually such arrangements are handled on a split rate basis, i.e. the bank charging a lower rate than the insurance company. Participation also helps the banks to avoid a large concentration of risk in any one borrower.

Participation with banks has been an important feature of the lending program of the Small Business Administration. The bank generally processes the loan, makes the advance and the S.B.A. guarantees it. Participation may be immediate or deferred. In certain cases the S.B.A. makes the initial loan and the banks take it over after a few years. About 60-70% of all loans granted by the S.B.A. are on participation basis.

Agreements between the principal bank, the participating banks and the borrower are drawn up after negotiations. These agreements are rather elaborate complicated documents setting forth not only the detailed terms of the loan but also rights of the participating banks with regard to the securities and providing for all contingencies. Provisions are included in the agreement to the effect that all securities, rights, benefits, liens, set offs, payments, etc. are for the benefit of all the banks in proportion to the credit provided. The principal bank receives repayments from the borrower and distributes them pro rata amongst the participants and for this purpose it is deemed to be an agent of all the interested banks. Sometimes only a certificate is issued by the principal bank to the participating banks, denoting their respective shares in the credit.

Considering the large outlay of funds that would be continually required by manufacturing concerns to keep abreast with the technological improvements, automatic processes and equipment, it appears that participation finance will play a dominant part in meeting the credit needs of the industry.

ADVERTISING AND BUSINESS PROMOTIONAL ACTIVITIES BY U.S. BANKS

BY

Mr. A.L. Sathappan
Staff Officer
The Indian Bank Limited

In the United States of America many types of advertising on all sides attract our attention when we walk on the streets, drive an automobile on the highways, ride a street car, watch Television, listen Radio, read Newspaper or Magazine or open our Mail. In addition to these types of advertising, the banks are turning to the "casual publications" such as attractive booklets, pamphlets, brochures and folders, which win the attention and interest of the public. The banks use advertising extensively with a view to familiarise their customer and the public with the services and the facilities they offer in order to create a favourable attitude towards the banks. Most of the banks continue to follow a progressive advertising programme which is becoming an increasingly important factor in the development of new business for the bank. Practically all advertising is expected to build institutional goodwill to some degree but in most cases this may be the primary objective.

The American Bankers' Association helps banks through its Advertising Department. It supplies information, suggestions and actual aid materials. Approximately 60% of the country's banks use its services. The department furnishes newspaper mats, direct mail advertising (blotters, folders, booklets) lobby and window display posters and radio and television aids such as recorded and typewritten spot commercials, ready to appear locally as bank's own exclusive product. The newspaper service includes a "proofs-in-advance" plan for banks seeking to promote a variety of services and numerous special series covering a wide range of banking and trust services. One of the Department's highly successful projects has been the special savings campaign on the theme "The Bank is the saver's best friend." "The School Saver" issued three times a year by the Department for pupils of 9-14 years, features school savings accounts and a general thrift theme.

The Banks in the States enjoy public confidence and support. They realise the value of public relations, customer relations and community relations, without which the banks cannot achieve their objects and the business cannot operate successfully. The progressive bank's activity is to build goodwill and bring better public relations. More and more it is now being realised that almost every one of a bank's functions has an active role in any effective scheme for developing a better public attitude towards the bank individually and towards banking and bankers generally. The banks train the personnel intensively so that it would serve as a real force in bringing about a better atmosphere in which to do banking as they realise that cultivating the goodwill of the customers requires team work and the cooperative effort of every department and every member of the staff. This is because the bank has to sell its service and it is judged not by what it says about it, but how it actually renders it each time to a customer who has any dealings with it. The banks very often revise what they offer in terms of the public's interest. They interpret it in terms of interest that is human and personal. As soon as they revise their plan of service they call attention to it by means of publicity.

The banks are adding a number of features in order to make its service efficient and attractive to the customers. One very popular move is the air conditioning of the main banking floors. Others include personal imprinting of checks for Special Checking Accounts, the establishment of "express" teller lines, and the opening of offices with "drive-in" facilities, and the development of inter-office deposit system. Many city banks have provided parking lot right next door. They keep pace with changing conditions and are alert to the developing requirements of the community they serve. The banks accord very good treatment to their customers in order to keep them in good humour, as a satisfied customer may bring them new customer through his recommendation.

There are other opportunities to build additional good-will by rendering some service to the customers. The banks offer a good deal of practical management assistance to their customers on a free basis as their interest is strongly in favour of helping small firms to prosper and grow. In addition to money-lending activities which are well-known, many banks offer the following advisory services:

Financial management assistance; Trust information; Help in finding and placing management personnel; Guidance on credit policies; Aid with record keeping and reporting techques; and Analysis of current and future business conditions.

They further provide valuable information on the credit standing of business concerns and individuals.

The officers and the other members of the staff are trained with the definite end in view of bringing about closer friendlier personal contacts with all types of people in the community round about. The managers and the other senior officers are very popular and friendly with the public. The advertising and publicity departments try to make the bank popular. The public relations department try to build goodwill and create a favourable attitude in the minds of the public by its activities. The business development department try to increase the business by aggressive personal contact and direct business development activities. Some banks adopt ultra-aggressive tactics in an endeavour to win for itself a firm acceptance in its community's life.

'PROCEDURES AND BANK ASSISTANCE TO CLIENT IN DOCUMENTATION OF LOAN APPLICATIONS

BY

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Controller of Advances
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The subject of my talk is "Procedures and bank assistance to clients in documentation of loan applications".

The completion of a loan application is the first step to be taken when a party approaches the Bank for accommodation. This most important document should throw considerable light on the standing of the borrower, the nature of the advance, as also its liquidity and safety. It is, therefore, essential that the information supplied in the loan application form, which is the basis of the borrower lender relationship, is fully comprehensive.

If a sound, well-thought-out loan decision is to be made, it is very essential for the banker to know:-

a) the borrower and his financial position;
b) his business, its nature and trends;
c) his full requirements and the purpose therefore;
d) his repayment programme and his capacity to implement it; and
e) the nature of, and any disabilities attaching to, the securities offered.

The importance of this information cannot be over-emphasized. In a recent survey conducted in the United States, 57% of the replies received to the query in regard to the cause of loan losses revealed that the absence of a closely administered loan repayment plan was the most frequent cause of such losses. Failure to outline and to agree upon a definite loan re-payment plan, at the time the loan is made, jeopardizes the Bank's position. Similarly, it is imperative to obtain authenticated information about the financial position of the borrower if losses are to be avoided. In the last resort, a loan is only proved good when it is re-paid. A good loans officer, therefore, should have in his credit file all the above information which should be kept upto date and properly investigated from reliable sources.

In the United States most of the banks have separate forms for each type of loan. The questions on the loan application forms are framed in a straight-forward and simple manner. No question is asked which the customer should hesitate to answer, but every effort is made to extract the utmost information from the borrower. The loan application form is signed by all parties concerned. Every assistance is given in explaining the full implications of the form so that the maximum disclosure may be made by the borrower. All the information given in the loan application form is thoroughly investigated from different sources and finally a personal interview is arranged with the borrower at his own premises. This is of the utmost importance in that it permits the bankers to see the borrower's plant, equipment and the labour relations. The assets and liabilities of the company, surplus statement, profit and loss statement and other statistical information may reflect the policies and decisions of the management, but a

personal interview on the spot goes behind the figures and provides comprehensive factual information which cannot be obtained otherwise. If needs be, a conference with the borrower can also be arranged in the bank to discuss the important points of his loan application, but in any event every effort must be made to bring on record all available data as to the credit-worthiness of the customer. It is to be added that pamphlets are issued by the American banks from time to time to explain the various types of facilities they offer. Similarly, advertisements are periodically placed with newspapers and financial magazines to attract potential borrowers. Further, the banks, in order to assist customers in planning for expansion and other such matters, have made available to them the services of their research departments. Some of the big banks have in fact also placed the services of highly technical personnel at the disposal of customers. Such persons frequently visit the business places of borrowers in order to assist them in comparing estimates of their future financial requirements.

In India, due importance is not always given to the loan application form. Also, some borrowers are reluctant to fill up the forms and tend to give evasive replies to the questions asked. Moreover, in our country, we have no reporting agencies as such and banks are disinclined to exchange full information in respect of borrowers. A further complication is that the majority of borrowers do not maintain proper statistics in regard to their business which renders it all the more difficult to assess their true position.

I feel it is a high time for the banks to endeavour to educate their clients in maintaining proper statistics so that, when accommodation is required, the requisite data may be readily forthcoming. Also, in their mutual interests, the banks themselves should not hesitate to furnish comprehensive reports to each other when a customer of one institution seeks accommodation from another.

INVESTIGATION OF LOAN APPLICATIONS

BY

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The two main objectives of credit policies of banks in the United States of America have been to provide adequate volume of credit to the ever increasing needs of an expanding economy and to seek to preserve what is considered to be the essence of the American economic system, namely free competition. They endeavour to encourage and assist in every possible way a competent businessman of good character, producer or distributor, provided the loan conforms to their policies, is justifiable in the light of the economic condition of the area and there is no doubt about its recovery. In their effort to achieve the objectives, they have adopted several new innovations, the two outstanding in recent years being Term Loans and Consumer Loans. Credit is provided on a substantial scale to consumers.

However, as trustees of the depositors' funds, banks are not in a position to take more than a reasonably calculated and intelligent risk. All applications for loans are, therefore, thoroughly investigated before decisions are taken.

Character is the foundation of trust. The banker, therefore, at the outset, satisfies himself in regard to the character and integrity of the individual or individuals connected with the management of the business. If he has any doubt whatsoever, he does not give any further consideration to the application. There is no degree of honesty to a banker.

Experience had shown that business failures were mainly due to management inefficiency. The largest number of failures was due to a junior employee experienced in certain management functions undertaking the control of an entire business. According to Dun & Bradstreet, ninety per cent of the business failures were due to the lack of management and business ability. It is, therefore, but natural that the banker should attach considerable importance to this credit factor. He ensures that the management has experience in the line of business, the ability to plan and to execute the plan and the capacity to cope with almost any adversity. In the case of a term loan, he further ensures that there will be continuity of good management during the period of the advance and that there is a secondary group of men capable of taking control of the business at any time and conducting it efficiently.

The applicant is required to submit financial statements. They reveal the financial position of the business and indicate how the business is conducted. From the latest balance sheet the banker ascertains, inter alia, the capital, the net worth (total assets minus total debts), the working capital (current assets minus current liabilities), the current assets/current liabilities ratio known as the current ratio, the relationship of the applicant's investment (net worth) to the funds contributed by creditors, the sales/receivables ratio, the cost of goods sold/ inventory ratio and the relationship of net profits to sales. Balance sheets of three to five preceding years are also obtained and a comparative study made to see whether the applicant's record of progress has been satisfactory. A banker usually maintains analysis of balance sheets of other parties in the same line of business. This enables him to arrive at a more precise assessment of the applicant's position.

No loan is granted without an appraisal of the applicant's ability to repay it and an examination of the sources from which it will be repaid. Term loans can only be repaid from earnings. The applicant is, therefore, required to submit an estimate of the future of his business with a record of the past earnings and a projection of his future earnings. The projection is checked by appropriate tests and the banker sees that there is a reasonable relationship between the past and projected sources of funds. He also examines the applicant's contemplated future uses of funds and other sources of funds, if any, and ensures that the applicant will be able to repay the loan without impairing his net working capital. Even though a loan may be secured by collateral or guarantee, no banker looks to it for repayment.

Except in the case of first-class parties and, at times, in the case of smaller parties where the banker has no reservations about the applicant's character, integrity and ability, the banker usually insists on a loan being adequately secured. While investigating the loan application he verifies that the applicant has a suitable collateral to offer. If a business is owned by a family or a few stock-holders, the guarantee of the principal members of the family or stock-holders in their personal capacities is sought.

The banker also examines the nature of the applicant's business and the purpose of the loan. The product or service supplied by the business financed must meet a public need and there must be ample supply of the required raw materials or of processed or finished goods. In the case of a term loan, the banker makes sure that the position in regard to these factors will continue to be satisfactory during the period of the loan. The banker does not consider a loan justifiable unless its purpose is to assist the applicant to maintain or improve his competitive position.

The key to successful lending is said to be an effective system of follow-up. The banker is vitally concerned with the use to which the borrowed funds are put. Therefore, while considering the other credit factors, he satisfies himself that the applicant keeps his accounts and other records in a systematic manner and that they will be available for inspection whenever required.

It will be observed from the foregoing remarks that a banker is not only expected to acquire proficiency in assessing an individual's character and ability and to be capable of interpreting his financial position from the various statements but also to possess adequate knowledge of the position of the many lines of business or industries and be familiar with the latest business trends and practices. A prominent American banker defined a successful banker as follows:

> "A successful banker is composed of about one-fifth accountant, two-fifths lawyer, three-fifths political economist and four-fifths gentleman and scholar - total ten-fifths-double size. Any smaller person may be a pawnbroker or a promotor, not a banker".

CREDIT INVESTIGATION BY BANKS AND INTER-BANK EXCHANGE OF CREDIT INFORMATION

BY

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The objectives of a Credit investigation Department, or Credit Department, as it is called, are to serve:

a) "Customers by acquisition and dissemination of credit information and other data in connection with their specific problems, and by properly giving suppliers or others whom they refer to Banks sufficient data regarding Bank's account relationship to substantiate the credit involved"; and

b) "Loaning and other divisions of the Bank by establishing and maintaining credit files and by assembling credit information from time to time as may be required by these divisions".

The two main functions of this department are:

1) Investigation; which has several sections collecting information from all sources. This information is collected not only with a view to determine the worth of the party but also to establish if it is credit worthy

2) Analysis: In U. S. A. all advances are by way of loans and not by way of cash credits or overdrafts, as we have in this country. This department is, therefore, very important as all loans - short or term - are granted on the basis of the ability of the party to repay from net earnings over a period. The method of analysing Balance Sheets and Statements is standardized throughout the country and it can be generalized that if the party cannot repay a loan from its earnings, it won't get the loan.

This is a very important feature of American Banking and has a great impact on the economy of the country as these repayments of loans result in compulsory savings both for the individual and the business and add to the resources of Banks every year thereby increasing the available capital in the country.

As a rule the Credit Department men do not call directly upon any individual or company and are prohibited from contacting any of their office or branch representatives or customers on whose behalf the Bank is conducting the inquiry with the result that the borrowers have no contact whatsoever with the Credit Department which practice is completely at variance with what prevails here.

It will be agreed that the Credit Department is a foundation on which all advances are granted and it is necessary that our records should be complete with all details.

In the States the business structure is mostly that of an Incorporated Company whose audit by a public accountant is compulsory. I feel a great leeway has to be made up in our country where we have no specialized agencies for giving information and where the business structure is mostly proprietory or partnership where accounts are not audited by any registered accountant. Besides the average customer in this country is most reluctant to give details of his business and assets with the result that the Banks have very little information on them.

In our country the law recognizes only registered partnerships and I would suggest that all such partnerships should be compelled by law to have their accounts audited by registered accountants so that authentic statement of affairs are available to those who have to extend credit. This legislation is necessary if the Banks are to play a proper role in the developing economy.

Exchange of information between Banks:

The immensity of information which the Banks in the U. S. A. exchange between themselves was revealing to us. This practice is in complete contrast to what prevails in this country and has been there for several decades. The Banks in U. S. A. follow a Code of Ethics for the exchange of information, details of which are known to most of you.

To illustrate, the Banks would give full information stating the history of the account, the loans given, their opinion on the strength of the endorser, on the guarantor, and their own judgement on the borrower giving full details on the borrowings. The most amazing thing is that they also give their own recommendations on the transactions involved.

In exchanging information the most important rule which the Banks have to observe is that if you obtain information from a bank about one of its accounts you must not solicit the account until six months have passed. Moreover, if you tell the other bank that you are actively soliciting the account - before you receive the information - the rule does not apply.

We were told by the Banks in the U.S.A. that they have not lost any business as a result of the exchange of information. On the contrary they take pride in stating that the progress of the banks is largely due to the fact that they are able to exchange complete information about customers who dare not hide anything from their Bankers. This is also well known to the business community with the result that they give the fullest information. It is, therefore, not surprising that the losses of the banks are few and there have been very few failures during the last 25 years.

As a contrast the information which the banks in this country give is most scanty and sometimes misleading. The information records of the banks in this country are not as detailed or as comprehensive as they should be. There is, therefore, great scope for the development of proper Credit Departments in a very thorough manner.

As stated before, we have no special private agencies like "Dun & Bradstreet" in U.S.A. or "Seyds" in the U.K. which will give ready information, but I would emphasize that the banks abroad do not merely rely on special agency reports as they have their own department which investigates.

I would, however, state that the greatest need of the hour in our country is more exchange of information between the banks. When I was in the States and even after my return, I have discussed the need for this with some of my colleagues in other banks. While they realise its importance, they fear that their bank may lose business, if they gave full information to a competitor. I would, however, suggest that the banks here should evolve a Code of Ethics which would not only prevent any loss of business but in fact make it more sound. In a developing country like that of ours where banking business is still in its infancy there would be plenty of business and borrowers in the years to come.

I would request my friends who are present here to discuss with their respective banks and convince them of its importance and if necessary, we can meet again to evolve a code of ethics.

If the Banks cannot agree to any code of ethics for exchange of information then I would suggest that the banks organize a separate credit agency which can collect information from all banks and other sources and pass on the same to the enquiring banks. It has been suggested that the Reserve Bank should undertake this work, but to the best of my information, no central bank of any country does this. In any case, if they did it, the information will be merely statistical and will not be of the type required

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LOAN NEGOTIATIONS, PROTECTIVE CONVENANTS AND QUALIFICATION OF TYPES OF LOAN COLLATERAL

BY

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American banking practices have developed by a process of evolution best suited to the growth of a new country and its developing economy. This might be a basic difference from the Indian situation which by historical background has been moulded by the British pattern. Although India is an ancient country, the developmental phase of its economy is of recent origin. In this sense India is in the position of a new country, still finding its feet, and there is full scope for the application of American banking practices fruitfully to Indian conditions. The present discussion will have to be viewed in this context.

Loan negotiations form a distinctive feature of U.S banking operations relating to term lending. In America, a term loan originates usually as a result of a set of special circumstances having a background of industrial development banking. To suit this background certain well laid qualifications for credit are applied and they are concisely referred to as the four C's namely, character, capacity, capital and collateral. Recently writers like Edward F. Gee have added a "Fifth C" - "Conditions", meaning thereby Economic Conditions or that combination

of external factors playing on credit risks in the long run. Essentially, emphasis is laid on the borrower's integrity in business for which purpose a close and technical scrutiny of his financial statements is made and thorough credit information obtained and also on his ability to pay. The capacity of the borrower is further related to his ability to repay out of profits and not out of any source. This requirement necessarily leads to an emphasis on sound management and adequate capital structure of the borrower. Thus, while the borrower's ability to repay out of profits and his integrity qualifies him for credit, the security offered by him is not of primary importance. It appears that out of the four C's least emphasis is laid on collateral. The American banker relies mainly upon the other qualifications and absence of collateral is not generally considered to be a bar to a loan. (Lest there be any misapprehension, it may be stated that this position holds good in respect of larger cities and towns in U.S. and in smaller towns, particularly in the interior of the country, banks as a normal practice insist upon suitable collaterals for loans). This is perhaps due to the fact that greater emphasis on security means looking only to the immediate interests of the lender and neglecting the interests of the general economy or of the particular industry.

To summarise, according to American banking practices, the fundamental attributes of good credit are sound management and absence of concentrated risk, as evidenced by adequacy and flexibility of earning power and quantity and quality of capital. As a result, after taking into account environmental and organisational circumstances, such as the general economy and conditions in the industry, substantial emphasis is laid on the source of repayment and the creditworthiness of the borrower. The stress on the twin factors of earning capacity and sound management, depending upon the lender's confidence in the ability, resourcefulness, integrity and continuity of management of the borrower, discloses a progressive system of loan negotiations, geared to suit the needs of industrial financing.

Closely connected with the above principles of loan negotiations are two special features of the American banking system, namely, (1) participation loans and (2) organised credit investigation and information system.

Participation loans are loans made to a borrower by a number of banks and/or other financial institutions jointly or severally under specified limits regarding each and operating through the agency of one of the lenders. Such loans have a direct bearing on the principles of loan negotiations because of the following factors. Such participation loans mean the availability of greater finance to the borrower with the risk being shared by and limited in the case of the individual lenders. This would considerably facilitate loan negotiations which will not be the case if a substantial loan is to be given by a single lender. Participation by number of institutions would result in greater attention being drawn to the management and earning capacity of the borrower. I have come across a loan transaction in which over 50 institutions (banks and other financial institutions) participated. Smaller banking units which are not in a position to advance a big loan or to conduct the loan negotiations effectively can participate in such loans with benefit both to the lender and the borrower. In the absence of such a system the only alternative would be to take a number of loans from a number of institutions which might give rise to conflict of interests and which would hamper loan negotiations by the attendant delays, duplication of documents, further cost and avoidable restrictions on the borrower's activities.

The progressive methods of American banking in regard to loan negotiations have led to a highly organised credit investigation system with well trained credit executives, who analyse past financial statements of the borrower and his financial plans for repayment and make a comprehensive report not only on the borrower but also, if required, on a particular industry. It is not necessary to emphasise the importance of such organised credit information and investigation system to the technique of term-lending and connected negotiations. It is stated that the background of the trained executive is -

(a) accurate appreciation of the importance of figures and facility in using them in credit analysis.
(b) ability to analyse economic factors and changing events.
(c) knowledge of accounting.
(d) working knowledge of commercial law, corporate law, banking laws, tax laws and labour laws.
(e) familiarity with marketing techniques and institutions.
(f) knowledge of psychology.

It is to be appreciated that a material factor in loan negotiations is the executive in charge of the loan negotiations and his competence to perform the functions. Realisation of the import-

ance of this aspect has led to the provision for facilities for training in U. S. through universities, training institutes.etc.

Indian banking practices regarding loan negotiations do take into account the integrity of the borrower and its capital structure. There is also an adequate appreciation of the necessity to examine financial statements relating to the borrower. These are, however, dealt with mainly on the past history or the present position of the borrower and there are not adequate facilities to analyse a loan proposition in the perspective of the future. Credit analysis has not developed in India in the acute and advanced manner of the American system. Further, inadequacy of capital to meet the requirements has led to an imbalance in the distribution of loans without regard to the principles of loan negotiations. There is no organised credit information system which enables the lender to choose his borrower consistent with the larger interests of the country or a particular industry.

A more noticeable feature in India is the primary emphasis laid on the security. Unlike his American counterpart, the Indian banker looks first and foremost to the security and thus emphasises mainly the protection of his own interests. Absence of security or inadequacy of security, acts as a bar to a loan. This conservatism vitally affects loan negotiations and to a great extent hampers industrial financing, which should take care of the source of repayment and the maintenance of normal capital investment in business.

The American practice in this regard appear to have an obvious advantage in that it evaluates the customer's problems and requirements. The borrower's ability to repay out of profits would serve the dual purpose of securing (the liquidation of) the banker's dues and also assisting in developing the borrower's business operations. All that would be necessary for the lending bank is to ensure that the loan proceeds are applied to the intended use and to maintain contact with the borrower and to keep abreast of his situation. On the other hand if the lender is to look to the security, first and foremost, in all likelihood it would hamper the activities of the borrower and might result in the lender having no incentive to follow the loan and its application to the intended use.

Protective covenants in a loan agreement taken in U. S. usually redound to the benefit of both the borrower and the lender and are not so stipulated as to be oppressive to the borrower. It is natural that the loan agreement should provide for reasonable remedies to the lender if the conditions and the terms of the agreement are violated by the borrower. Thus the covenants are stipulated in order mainly to meet the requirements inherent in term-lending to industry and are also somewhat influenced by the principle of looking largely to the character of the borrower and his capacity to repay out of profits and not following the security, first and foremost. The covenants are usually framed in such a way as to assure that the borrower's resources will not be dissipated, that profits will be employed for reduction of the debt, that there will be a continuing accretion to net working capital, that proper emphasis is laid on the management aspect, that there will be a curb on over extending capital expenditure etc.

The covenants are classified into Positive or Affirmative and Negative covenants and are included in separate clauses in the loan agreement. The positive or affirmative covenants lay a duty on the borrower to do certain things or take certain actions, while the negative covenants are stipulations in the nature of prohibition against doing certain things or taking certain actions. For a proper appreciation of their importance, the more important of the covenants may be summarised.

Positive covenants: The borrower will agree to:

1. do all things necessary to preserve its coporate existence and rights, comply with all the laws applicable to it and maintain and protect all its properties and assets. taking insurance wherever necessary.

2. promptly pay and discharge all taxes etc. and all labour claims except those that can be contested in good faith.

3. furnish to the bank periodical statements, certified by independent public accountants, showing financial condition, results of business operations, and other relevant matters.

4. execute and deliver to the bank necessary assignments and documents and also authorise the bank to act as agent of the lender to recover or sue for assets assigned.

5. maintain a specified net current assets.

6. use the loan proceeds for specific purposes and intended use.

7. limit the aggregate amount of borrowings to a specified amount.

8. make repayment of the bank's loan as stipulated.

9. maintain all books and records necessary for the business of the company and cause its subsidiaries to do so.

Negative covenants. The borrower will agree that, without the consent of the bank, it will not -

(a) incur any other indebtedness other than tax and other current liabilities.

(b) create any mortgage, pledge, lien or other charge over the assets of the borrower other than those regarding the bank's loan or liabilities or liens imposed by law (negative pledge clause).

(c) give guarantees or undertake obligations on behalf of others.

(d) enter into conditional sale or title retention agreement by which contingent transfer of property of the borrower is contemplated.

(e) make loans or advances to others exceeding a specific limit.

(f) transfer the borrower's undertaking or consolidate or merge with other corporations.

(g) declare dividends exceeding a certain limit.

(h) incur capital expenditure beyond a specified limit.

(i) part with control over capital stock or subsidiaries.

(j) increase the salaries or bonuses of employees.

(k) make foreign investments.

In cases where the borrower either has subsidiaries or is itself a subsidiary, some of the restrictive provisions are applied to the subsidiaries or the corporate group.

It will be observed that these covenants are influenced by the distinctive credit policy followed by American banks where emphasis is laid upon character and capacity of the borrower. Thus the covenants are generally designed to ensure that the borrower's resources are not frittered away or hampered, that the indebtedness will be wiped out by applying profits and that the borrower's business is strengthened by a continuing addition to net working capital.

The conventional practices prevailing in India and the basic emphasis on security tend to eschew or minimise the importance of covenants of the above type. No doubt, some of the fundamental covenants such as adhering to repayment programme, compliance with laws, submission of periodical statements etc. are usually included in documents taken in India. But these covenants are not pursued to their logical ends and the loans are not followed with a view to ensure their application to the intended use. Essentially, the lack of incentive in this direction arises out of the insistence on and looking to the security which has in its turn influenced the framing of the protective covenants. By and large, the covenants stipulated in India deal with the perfection, protection and the non-impairment of the security. In this regard it may be pointed out that although banks operating in smaller towns in the U.S. normally insist on collaterals, the protective covenants in the documents taken are not based mainly for the protection or preservation of the security but also for better management and improving the earning capacity of the borrower.

Since there is scope for introducing in India the American practices regarding lending policies, the application of such policies might consequently necessitate changes in documentation and the nature of the protective covenants on the American pattern. While adoption of the covenants included in American loan agreements would be advantageous to the means to be served, there are certain psychological and legal difficulties. It is apprehended that the Indian

business men are too sensitive and might resent any covenants which place restrictions on their management. Further, it is not beyond doubt whether covenants restricting increased salaries or bonuses will be legally sustainable.

Incidentally, it is observed from a study of American loan agreements that a usual clause is that the borrower represents and undertakes to produce a favourable written opinion from its own counsel in a form acceptable to the counsel of the lender regarding the organisation of the company, its corporate status, the proper authorisation and execution of all documents, the validity of the promissory notes or collaterals etc. Such a certificate from responsible counsel would go a long way in avoiding unnecessary documentation, waste of time and expenditure. This procedure could be very usefully adopted in India on a uniform basis.

Qualifications of types of loan collaterals:

Depending upon circumstances in U. S. it is sometimes considered advisable to add to the safety of the loan by taking collateral. Generally speaking, however, in U. S. collateral or security is not insisted upon except in cases of necessity or of banks operating in smaller towns in the interior of the country. This security may be plant and real estate, equipment, stocks, bonds, assignment of claims or other assets etc. In this respect the practice followed in India is more or less the same. What may, however, be followed in India with advantage is the practice of insurance companies participating in special loan agreements, which afford certain types of collaterals. Another aspect in taking security in the case of goods and merchandise is the Uniform Trust Receipts legislation in America which enables the lender to have trust receipts as collaterals, whenever he has to part with possession of the goods or merchandise. The absence of suitable legal provisions in India has rendered trust receipts valueless to the banker when lending on the security of moveables.

In the light of the foregoing and having regard to the developing economy of India the following U. S. practices can be fruitfully followed or adapted:

1. Development of loan negotiations based on the integrity of the borrower and his ability to repay out of profits. Suitable provisions may be made and steps taken to enable the lender to ensure the application of the loans for the proper and intended purpose.

2. Development of organised methods of credit investigation and analysis based upon specialisation and technical analysis of financial statements. This will enable the adoption of techniques viewed in the perspective of the future. For this purpose adequate educational and training facilities may be provided.

3. Encouragement and adoption of participation loans by number of institutions. This would to a great extent protect against stringency of credit, provide for easier negotiations and avoid needless documents and expenditure.

4. Enactment of legislation on the lines of the Uniform Trust Receipts Act may be worthwhile.

TECHNICAL AND OTHER SERVICES RENDERED BY BANKS IN THE U. S. TO THEIR CLIENTS IN INDUSTRY

BY

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It is a recognised fact that a bank cannot grow and prosper unless the community which it serves also grows and prospers. With a view to ensuring their own progress, banks in the United States of America adopt dynamic and progressive practices and encourage industry and agricultural diversification through constructive and intelligent granting of credit. Investigation of a loan application and the follow up of the loan after it has been granted, enable the loaning officer to know exactly when and where the shoe pinches and he immediately proceeds with the

diagnosis of the trouble. A study of the financial statements of the borrower for the past several years before granting a loan reveals to the loaning officer the past story of the borrower's performance. Will the borrower be able to repay the bank's loan and has his performance been satisfactory as regards sales and profits earned, is the industrial concern able to meet competion from other similar concerns - are some of the questions, which are studied in detail. In this process the loaning officer is able to find out whether the capital structure of the industrial concern is sound, its sales sufficient in volume, its operations economic and its management efficient; also whether receivables are being promptly collected and creditors regularly paid by the concern. If not, the loaning officer, who is a man of considerable experience and is fully acquainted with the local conditions, discusses with the borrower the particular problems in detail and suggests to the borrower what means he should adopt to set the position right.

2. Larger industrial concerns have persons of wide and varied experience on their management; they also have the necessary research and statistical departments and are therefore able to look after their affairs themselves. It is mostly in the case of small closely-held corporations in the hands of unseasoned businessmen that the financing banks render valuable technical and other assistance. A few examples will illustrate how this is done.

(a) A concern manufacturing glue was doing very well. Later its sales and profits began to decline. The usual follow up of the advance by the financing bank revealed to them that there was something wrong with the concern and the bank during the course of its investigation of the reasons had the product chemically analysed, but nothing wrong was found. The sales manager, was, however, found to be very old and rather inefficient. The bank advised the concern to appoint a young and energetic sales manager and to consult an advertising agency. The advertising agency's investigation disclosed that the cartons in which the product was sold were not attractive. This was remedied and the concern is doing very well again and is able effictively to meet competition from similar other concerns in the area.

(b) An engineering company has specialised in the manufacture of precision instruments. Despite the fact that the proprietors knew the technical knowhow very well and were doing their best to promote sales, the company could not achieve profits usually earned by a concern of its size. In the follow up of the advance the bank diagnosed their trouble and advised them to engage a competent accountant to look after their operational expenses. In fact they even recommended a good accountant for the purpose. With the control of the operational expenses by the accountant the concern is now doing very well. During my interview with the proprietor he profusely expressed his gratitude to the bank for the assistance extended to him, which was not purely financial.

(c) In the case of a radio tube manufacturing company the financing bank, realising that tube radios are being gradully replaced by transistor radios, advised the company to introduce the manufacture of parts of transistor radios and this proved very profitable to the concern.

3. An instance of negative assistance will also be useful in illustrating the part played by banks. A customer with the technical knowhow and with ample resources to start a business approached a bank for an advance for working capital. The bank after analysing the proposal turned down the loan saying that the articles which the borrower intended to manufacture were out of date. The borrower had not till then realised this fact and felt extremely grateful to the bank for enlightening him on the point.

4. For rendering such assistance, banks have naturally to keep themselves in close touch with production and marketing problems and quite a number of them have even started their own research departments to advise borrowers on labour, statistical and marketing problems. Some of the larger banks have technicians such as engineers and persons conversant with oil industry techniques on their staff and such staff is consulted on the borrowers' problems. Where, however, the banks find that a problem requires consultation with a specialist, the borrowers are suitably guided in this regard.

5. Another way in which banks have assisted industry considerably is by stimulating sales by granting consumer credit without which sales could not have achieved the present level.

6. Banks in India can considerably increase their contribution to the rapid development of the country's economy by maintaining closer contacts with their present and prospective borrowers and trying to study and solve their problems not only in the field of finance but, as in the case of the American banks, other directions also.

FOLLOW-UP BY LENDING BANKS ONCE A LOAN HAS BEEN GRANTED

BY

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After sanctioning a loan and obtaining the necessary supporting documents, the next step the bank takes is to make sure that the loan is utilised for the purpose for which it was granted. A shrewd banker usually does this by closely watching the account of the borrower and scrutinizing all large cheques drawn on it. If any cheques are issued in favour of other financing institutions or stock-brokers or the borrower's own subsidiaries, he at once makes further enquiries with the borrower regarding the nature of these payments.

Short-term loans do not offer much of a problem to a banker so far as follow-up is concerned as they are more or less of a self-liquidating nature and are generally extended to supplement the borrower's working capital during the season.

Term loans (i. e. loans with a maturity exceeding one year), which are invariably granted for financing fixed assets, on the other hand, call for greater vigilance on the part of the banker, repaid as they are over a longer period and out of earnings after taxes.

The follow-up in the case of term loans granted for business purposes, takes the form of maintaining a close watch over the activities of the borrower particularly in regard to (a) the due observance of all the affirmative and negative covenants detailed in the loan agreement and (b) calling for and scrutinising periodical reports from the borrower. The report usually called for are:

(1) Annual financial statement (i. e. balance sheet) audited by an approved Certified Public Accountant.
(2) Quarterly statements by book keeper, and
(3) Monthly Statements giving information on -

Aging of the Receivable	Aging of the Payables	Inventory
Cash in hand and with bank	Notes payable	Monthly sales

These statements enable the bank to keep track of the borrower's position and to offer guidance to him if necessity arises.

Other points which receive the attention of the bank Manager are:-

(1) Is the account actively conducted?
(2) Is the borrower over-trading?
(3) Is the business showing signs of over-expansion?
(4) Is the borrower withdrawing capital for outside interest?
(5) Is he extending credit liberally to customers?
(6) Are obsolete inventories included in current inventory?
(7) Do sales include large "sale returns"? Do the figures represent gross or nett sales?
(8) Are interest costs high? (These will indicate other borrowings).
(9) Are legal charges high? (These may indicate unbusinesslike practices).
(10) Are taxes being regularly paid?

In addition to analysing monthly statements, the bank Manager compares them with Robert Morris Statement Studies of the industry concerned and discusses with the borrower any large variations found in his statements.

Credit reports are periodically obtained from Dun & Bradstreet and/or Credit Bureaus and, if necessary, from other banks too. It is also usual to send round a representative of the Loan Division to the borrower's place of business for obtaining first-hand information on the business or industry and for checking on the trade.

If at any time a weak spot or danger signal is discovered in the affairs of the borrower, the bank takes immediate steps thoroughly to discuss the matter with the borrower with a view to evolving remedial measures before the problems assumes greater proportions.

Where projections submitted by the borrowers prove incorrect due to changed circumstances, fresh projections are obtained and the repayment programme is suitably revised by mutual consent.

In the case of loans against Receivables, the borrower's statements are verified with the books at frequent intervals.

If an instalment due on an Instalment Loan, Personal Loan or other type of loan falls in arrears, the bank endeavours to "educate" the borrower concerned in the first place and only when all attempts fail does the Loaning Officer pass on the deliquent loan to the "Collection Department" which then goes after the borrower to recover the outstanding.

STATISTICAL AND OTHER PERTINENT INFORMATION AVAILABLE TO BANKS IN THE U.S.

BY

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The usefulness of statistical data lies in the contribution they make to scientific induction. The different classes of statistical information available cover the entire range of the economic life of the nation. Such information is again presented in a manner suited for specialised application to the needs of the banking industry. In view of particular sensitiveness of banking to fluctuations in any and every section of economic activity, this subsumptive process has a particular significance.

2. The Federal Reserve Banks carry on research and survey at regional level on different aspects of the economy and in this they also, quite often, seek cooperation of various Universities, research bureaus and outside economists and experts. Results of such studies are published either in form of pamphlets or through the monthly bulletins. Particular mention may be made, here, of the publications by the Federal Reserve Bank of Boston, which is reported to have carried this type of research to a high degree of perfection. Two of their important publications are: Survey of Economic Opportunity in New England and Economic Review of New England. Similarly the Federal Reserve Bank of Dallas recently published the results of their research on finance for Agriculture, which deals with all aspects of Agricultural operation.

3. The Federal Reserve Board make their own assessments by the methods of market research and survey, on national basis and publish the results of such investigations with regard to (1) income, expenditure, individual holdings of liquid assets, savings and bond holdings, (2) consumer spending intentions, (3) consumer credit, and (4) growth patterns of different types of business including levels of production, inventory position, employment, profits and expectations for investment in new plant, equipment and inventories.

4. Field research organized by the American Bankers Association makes a close and detailed investigation of the relationship between various economic facts and trends and the present state and future growth of banking, from the point of view of the entire system as well as individual banks. The association further makes a constant research on bank costs and undertakes to assess why an individual bank loses business, what are the characteristics of its customers, and to suggest how the bank can increase its business, control its costs and improve and extend its relationship with the public. It also seeks to evaluate the public attitudes towards banking in general, reasons for such attitudes and it also suggests measures for removing any fears or misgivings detected in the public attitudes.

5. Robert Morris Associates make their own research with regard to all aspects of bank loans and customer credit investigations and make the results available to the member banks. They have developed the method of analysing customers accounts and publish Profit and Loss analysis of important corporations, industrywise and try to give a lead with regard to what should be a judicious pattern of profit and loss items and typical ratios between current assets and current liabilities in a particular industry. The National Association of Bank Auditors and

Comptrollers similarly make a continuous research and study on matters relating to "Operation" and "Audit". Their publications such as Bank costs, Audit programme for banks, Job evaluation, etc. are available to the banks and prove very useful.

6. It is realised that an individual bank must know the community it serves. National figures relating to industries, population shifts and other matters of economic import, therefore, require to be broken down to regional, state or local level. State Department of Commerce, the Federal Reserve Banks, University research bureaus, local chambers of commerce, etc. help organizing small-area data. There are also private research agencies and individual consultants who undertake investigation of particular problems.

7. With regard to statistics dealing with the transactions involved in the process of banking and information reflected in such transactions and/or incorporated in banks' books, the Federal Reserve Monthly Bulletin in the U.S.A. and the Reserve Bank Monthly Bulletin in India, appear to follow comparable lines. The U.S.A. bulletin also contains information obtained from outside banks' records, as does the Indian bulletin, but the coverage of the former is wider in that it contains information pertaining to (i) ownership of Government Securities, (ii) personal income, (iii) sales and stock of Department Stores, (iv) consumers credit, and (v) employment.

8. The annual Reports of the Federal Deposit Insurance Corporation contain statistics on different aspects of banking similar to those presented in the Annual Statistical Tables of the Reserve Bank of India. The former, however, gives ratios of items of operating earnings and operating expenses in relation both to operating earnings and total assets— the latter ratio is not given in the Reserve Bank Statistical Tables; but it is important that the ratio which reflects the relationship between banks' resources and cost and earnings, should receive particular attention.

9. Most of the major banks in the U.S.A. have their own Economic Research departments to make a continuous study of the economic trends as well as the trend in particular industries and offer prognostic assessment for the future. Needless to say that such study has been immensely facilitated by the complete range of statistics, with a proper accent on the needs of the banking system available to them and have put bank management on a highly scientific basis.

THE ROLE OF THE FEDERAL RESERVE BANK IN U.S. BANKING

BY

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The following words - which are illustrative of the Federal Reserve Bank system in the U.S. - appear on the walls of the Federal Reserve Bank of Boston -

> "In the Federal Reserve Act, we instituted a great and vital Banking System, not merely to correct and cure periodical financial debacles, not simply indeed to aid the Banking Community alone, but to give vision and scope and security to Commerce and amplify the opportunities as well as to increase the capabilities of our industrial life at home and among Foreign Nations."

In 1913, the Federal Reserve Bank Act was passed, and further tightened up after the debacle of 1930-31, establishing thereby the part that the Federal Reserve Banks would play in U.S. Banking, in so far as the National Banks were concerned - the Banks registered under State Charters being outside the scope of these regulations.

All National Banks in the Continental U.S.A. are required to belong to the Federal Reserve Bank System. Somewhat less than half of all banks in the U.S. belong to the System, but these banks hold more than three quarters of the total Bank deposits of the country. They are, nevertheless, subject to State Laws which are sometimes peculiar in their application.

For the purpose of administration, the continental U.S.A. has been divided into 12 Federal Reserve Districts, with one Reserve Bank in each district. Each of these 12 Federal Reserve Banks is autonomous in its functions. The Federal Reserve Banks maintain 24 branches in the principal cities of the U.S.A. - to perform for these territories most of the functions peformed at the Head Office.

Only National Banks can subscribe to the stock of the 12 Federal Reserve Banks, and 6 out of 9 Directors of the Boards of each Fed. are elected by the Member Banks in that area. The policies and actions of the Fed. have proceeded without any sectional pull or bias, because these representatives or Directors are there in an advisory capacity and are considered more as specialist. The constitution of the Board of the Fed. is such as to make the organisation work with the concentrate of the forces that go to make up the economic structure of the country.

The basic function of the Federal Reserve System is to make possible a flow of credit and money that will foster orderly economic growth. The Federal Reserve Banks are the principal media through which the credit policies and general supervisory powers of the System are exercised. They perform for Member Banks many of the services which Member Banks perform for the public. In addition, they are the fiscal agents, depositories and custodians of the U.S. Treasury and certain other Government agencies.

The Federal Reserve Banks' control over U.S. Banking is basically two-fold — Indirect and Direct —

1. INDIRECT, that is —

   (a) By raising and lowering the Discount Rate or machanism, as either an administrative or as a cost aspect. Borrowing from the Fed. is expected to be for only short-term and temporary purposes.

   (b) Regulation of the Statutory Reserves which Member Banks are required to keep with the Fed.

   (c) By Open Market Transactions through the purchase and sale of Securities and on the advice of the Open Market Committee.

   (d) By fixing marginal requirements for loans against stock-exchange securities, compelling when necessary the channeling of funds towards Trade and Industry.

2. DIRECT

   (a) By Inspection of Member Banks - which is both exhaustive and thorough.

   (b) Friendly relations with Member Banks through the Fed's Public Relations Department - through Liason and field officers to iron out any genuine difficulties that may exist between the Fed, the Banks and the public.

Some of the services which the Federal Reserve Banks render to U.S. Banking are -

1. The maintenance of the active and live Research Departments - which make a detailed field study on Banking, Industry, Agriculture, Mining, Retail trade, and the capacity of the area in which the Fed. operates. This Department maintains a very close association with Universities in the area, and gives grants to Professors and others who have special aptitude in a particular field. It is in close touch with Trade associations, with the Research Departments of large organisations and Corporations, with the American Bankers' Association and with Railroad and public utilities. It arranges seminars on subjects of general economic interest. An intensive study is made and information made available to anyone who would want it, and it operates in every sense as a "Service Department" for Trade and Industry in that area.

2. Free, frequent and quick remittances through highly mechanised processes.

3. Remittance of Cash to Member Banks in the District areas through the Fed's armoured Cars, at nominal cost. This facility has helped considerably the development of industry in remote areas.

4. Free Collection of Cheques of Par Banks - that is - Member Banks, whereby all cheques anywhere in the USA lodged by a Member Bank at one office of the Fed. will be collected free of cost by the Fed.

5. Collection of Bonds for Member Banks whereby the physical transfer of bonds from one place to another is avoided.

6. Retention of Govt. Funds - arising out of sale of Bond issues - with Member Banks for at least at fortnight.

By these and several ways the Federal Reserve Banks in the U.S.A. foster and nourish the growth of USA Banking - generating, above all, a feeling that all must get together for the common good and move towards progress in an understanding of each other's point of view. In equal opportunity, in understanding, and in common purposes, progress must follow.

BANK MANAGEMENT AND BRANCH BANK/HEAD OFFICE RELATIONSHIP IN THE UNITED STATES OF AMERICA

BY

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Bank Management in the United States of America is called with some justifications, the eighth wonder of the world. With more than 14000 banks and approximately 9000 branches - large banks and small banks, National Banks and State Banks, Unit Banks, Branch Banks, Group Banks and Chain Banks, Federal Reserve Member Banks and Non-Member Banks, par banks and non-par banks, Federal Deposit Insurance Corporation Member Banks and non-member Banks, the impression of a first class hodge podge is created. A closer analysis will however reveal the remarkably smooth, efficient and satisfactory flow of operations within a bank and as between various banks.

The most distinguishing feature of bank management in the United States of America is its dynamism. It permeates all fields of bank activity whether it be in the mobilisation of deposits, rationalisation of procedures, standarisation of methods, sale of service, distribution of credit, study of economic and business trends or client psychology or understanding of staff problems. A progressive outlook, a scientific approach, an aggressive effort and an unbounded enthusiasm to forge ahead constitute the dynamism of U.S. Bank Management. The rapidly growing economy of the country challenges bankers from many directions, new depositors, additional cheques, new demands for service and new customers. The manner in which this challenge has been met and overcome and the remarkable ingenuity exhibited in the designing of new techniques like term loans, consumer credit, financing accounts receivable, mechanisation, drive-in and walk-up windows etc., indicate the dynamism animating bank management. The aggressive approach is revealed not merely in the tackling of the day to day problems but in visualisation of those in the years to come and in the study of community problems and its institutions.

Public relations is a major management responsibility. It is in this field and in the field of advertisement and publicity that the progressiveness and dynamism of Bank Management is most distinguished. As in a manufacturing concern the sales mission is one of product improvement and product interpretation in order to obtain greater public acceptance and more favourable "brand image" of banks, bankers and banking service. Competitive and prompt personalised service forms the basis of party contact. Typical aggressiveness is noticed in all three aspects of public relations of approaching, informing and pursuading a prospective constituent. It is this approach that has fetched the description of "Department Store Banking" to U.S. Banking.

Accomplishments of banks in the field of economic research, time studies, staff recruitment and training programmes formulated to meet the requirements of a large and growing staff, and the increasing mechanisation of routine operations, evidence the scientific and planned approach of bank managements. A democratic outlook is indicated in the genial atmosphere prevalent in the banks, the freedom of junior members of staff to freely ventilate their views even though they may not conform to the views of the higher ups, the mutual respect and sense of equality between senior and junior staff, the intimate sense of association of the staff with the bank's progress and in the opportunity to all to offer suggestions for improvement through the suggestion box.

Although banking is carried on typically through unit banks, three types of multiple office banking are in existence- Branch Banking, Group Banking and Chain Banking. Of these, branch banking is most important; the other forms often being substituted for branch banking in States where it is prohibited or severely restricted. Federal law permits branch banking to the extent permitted by the State Laws.

With 600 and odd branches closely spread over the State of California, the Bank of America National Trust and Savings Association has developed a system of Head Office Branch relationship on which other banks having branches are patterning themselves. What is stated below is essentially drawn from the working of the Bank of America.

The branches of the Bank are divided into two divisions, the Northern Division and the Southern Division. Each division is in turn divided into District Operating Offices. There are 11 such offices in the Northern division and 12 in the Southern division. The District Operating Officers frequently visits branches in his district, once atleast in three months and ensures their efficient operation. He, however, does not have any loaning powers. He covers fields other than loans and lends weight to the suggestions of the Manager. One of the most important functions of the District Operating Officer is the rating of all branches and all officers from Manager downwards. The methods section of the bank determines, through time studies, the staff requirements of each branch. Deviation from this is a prerogative of the District Operating Officer and he has to explain his reasons to Head Office.

Managers of branches enjoy wide graded discretionary powers. They are authorised to delegate powers to junior Officers but not responsibility. The discretionary powers enjoyed by Managers are wide enough to leave sufficient initiative in their hands and are calculated to meet the normal demands of constituents at the branch. In addition to specific discretionary powers, Managers enjoy reporting powers whereunder they are authorised to exercise discretion and seek post facto approval of Head Office. At the Head Office lending limits stem from the General Finance Committee, a Committee of the Board. The General Finance Committee delegates authority to 5 Junior committees specifying the lending limits of each committee. Loan Officers at Head Office like Vice Presidents also enjoy loaning limits. The Junior Committees meet every morning and deal with the credit proposals received. Wherever feasible, the Manager of the branch also attends the meeting and clarifies questions raised. Expeditious disposal of all credit requests is thus ensured. Further whenever necessary, Manager gets into telephonic contact with Head Office. He has a direct line of approach to the President of the Bank. A close personal contact is also maintained between Head Office and the Manager by the latter's frequent visits to Head Office. Periodical audit of branches ensures proper adherence to the procedures laid down and the instructions issued. The high importance in which the branches are held is well expressed in the remarks of a Senior Officer of the Bank of America that "the men at the branches are the Bank, the people at Head Office are not. They are there only to administer and aid the branches".

CREDIT INVESTIGATION AGENCIES

BY

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The origin of credit investigation agencies, more commonly known as credit agencies or mercantile agencies, goes back to the nineteenth century, when the first of them was started. The need for these agencies arose from problems of over-rapid development in the U.S.A. in that century, - speculation, new and unsteady banks, the advent of inexperienced men in business, inflation, etc. - which led to depression, failures and bankruptcies. The development of new areas, floation of new concerns and increasing exploitation of resources of the country brought about the necessity of dealing with new persons and undertaking larger risks. It was realised that information on people, one was called upon to extend credit to, was absolutely necessary to eliminate avoidable risks. It is interesting to note that a man who had failed in business realised that the information he had acquired on parties he had dealt with could be used commercially by being made available to people who needed it. He founded the first credit agency in 1841. After its inception, there were many changes of name and mergers, before the existing organisation Dun & Bradstreet Inc. was evolved from it. A description of this important credit agency will follow.

It would be interesting to examine the functions of these agencies in the present economic set-up in the U.S.A. Since the formation of the first agency, the services rendered by these organisations have expanded very greatly. Information gathered and supplied has gained immensely in volume and variety, specialization in certain lines of business or industry, or in certain geographical areas has taken place, and services have been extended to include special surveys, studies and appraisals, preparation of charts, analyses, and all manner of statistics relating to business, publication of magazines and circulars dealing with trends in various aspects of trade and industry, showing of business films, establishment of business libraries, and provision of market planning, business counselling, consultation services and business courses. Important as the various services mentioned are, the main function of the credit agencies still is the collection of credit information and supplying it to their customers. The information gathered relates to individuals, firms, corporations and associations and it covers a wide range of activity. The credit agencies' reports cover detailed information on the following points:-

For Individuals:

Background information from birth, home environments, marital status, character, habits, resourcefulness, initiative, personality, reputation in business and social circles, past experience in business or profession, present occupation - affiliations, existing status and prospects in future, financial position, bank accounts, borrowings from banks and others, liabilities-business and personal, rating for settling accounts of creditors depending on promptness or slowness, litigation - suits, judgements, decrees etc.

For firms and Corporations:

Background information since inception, capital, names of partners or officers and directors, reports on partners or directors and principal officers covering personal information on them, such as business and social background, personality, resourcefulness, business experience, reputation in business circles, etc. Further information covers points relating to business, financial position, credit rating, litigation etc. as detailed under the heading for individuals.

In fact, credit agencies' reports cover every matter that their customers may be interested in knowing in respect of the subjects of enquiry. It sometimes happens that the enquiring customer of an agency is interested in certain special aspects of the subject's business or personality. In such cases, the agency would undertake a special investigation and supply a specially prepared report. Such special reports are supplied in addition to standard credit reports dealing with matters mentioned above.

There are two categories of credit agencies - general and special. The general category comprises one agency, Dun & Bradstreet Inc. It is called general because the agency supplies information on any individual or company in the U.S.A. and Canada. The other category of special agencies includes many and varied organisations, their chief feature being specialisation in certain lines of business or in certain geographical areas. A general description of both these categories of agencies is given below.

1. General Agency - Dun & Bradstreet Inc.,

Founded in 1841, this is the best known of all credit agencies. It has a large organisation, consisting of about 200 offices in the U.S.A., 70 offices overseas, and a large number of correspondents and credit reporters. Its activities, many and varied, may be summarised as follows:-

A. Preparation of a Reference Book. This publication is issued every other month, and contains about 3 million names on which information is given. The information is classified by line and function and each concern listed is rated as to financial and credit standing. Businesses in all parts of the U.S.A. and Canada are covered. Revision of the Reference Book takes place every other month. It is interesting to note that such revision takes care of changes in the reports at the rate of 5000 per day. Frequent revision and incorporation of changes ensures correct and latest information being available to subscribers.

B. Reports on businesses in the rest of the free world are also undertaken. These are similar to those on American businesses in form and content, and are collected by reporters operating in foreign countries. They have about 300,000 of such reports on their files.

C. Reserach has been undertaken on various aspects of business. Reports on the results of such research are available to customers. Some of the subjects covered are:-

Industry Appraisals, Market Appraisals, Sales Potentials,
Trade Attitudes, Consumer Customer Attitudes.

D. A special division for Apparel trade is maintained. It is called the Credit Clearing House, and it is designed to meet the special needs of this trade. It gives opinion on the advisability of extending credit in cases where a special element of risk is involved, based on the judgment of a special staff of analysts, who keep in constant touch with major operations in the trade. Data from the Credit Clearing House in New York is photographed on microfilm and airmailed to branch offices.

E. Special investigations are undertaken to meet the demands of subscribers not covered by standard reports. Examples of subjects covered are: background of the management of business and its owners, over all financial and operational studies, etc. The subjects are treated in a thorough and specialised manner, as, usually, such reports are asked for in connection with important deals.

F. Comprehensive credit surveys are prepared on states, counties, cities, school districts and other Governmental units covering economic and social characteristics, management, debt record and current operations. These are useful to banks and other financial institutions who may wish to invest in general obligation bonds issued by such bodies. A survey is published when such bonds for $ 750,000 or more are publicly offered for sale.

G. It maintains a department for collection of overdue accounts called the Mercantile Claims Division. Special methods and procedures have been developed by this division for collection of overdue accounts. The service is offered in the principal trading centres of the U. S. A. and Canada.

H. Counselling of businessmen is undertaken, particularly in the retail trade. Apart from direct advice, the agency provides special surveys relating to certain trades, containing typical operating and merchandising characteristics. Pattern statements are prepared from large numbers of balance sheets of specific types of business, and they provide average figures for each item in the balance sheet. Similar pattern statements are prepared for sales, gross and net profit, expenses, etc. They are very useful for comparison.

I. Publications of various kinds are issued. Guide books for salesmen are issued twice a year. The "Latin American Sales Index" published annually covers information on 160 000 businesses in Mexico, Central America, South American countries and West Indies. The Apparel Trades Book gives information on wholesalers and retailers in the apparel trade. A monthly magazine "Dun's Review and Modern Industry" contains articles on important business developments bearing on management and industrial techniques. News releases are issued to newspapers on important business matters, current statistics, new businesses, business failures, etc. Other releases are in respect of weekly developments in trade, the daily wholesale price index of 30 basic commodities, surveys of business, marketing trends, foreign trade, etc. There are, besides, charts and statistical analyses issued from time to time. An interesting chart relates to business failures and shows the distribution of failures and liabilities of concerns among various classes of business, and analyses the causes of such failures.

J. Documentary films on business matters are made available to business and educational groups free of charge. Besides, a business library is maintained in New York.

2. Special Agencies:

There is a large number of special agencies all over the U. S. A. As stated earlier, they specialise in certain lines of business or in certain geographical areas. Some of the more important ones in this class are described below:

National Credit Office, Inc.

Incorporated in 1900, it is affiliated to Dun & Bradstreet, Inc. and has its offices in

various centres in the U. S. A. It is the largest agency in the class of special agencies, specialising in reports on a wide field of business concerns. The agency also runs a consulting service on management problems. Reports on borrowers on commercial paper in the open market are issued, rating assigned to the borrowings and statistics concerning the commercial paper market compiled. A special service is maintained for the wheeled goods industry - automobiles, trucks, tractors, etc. and correspondence and lecture courses on credit analysis are conducted.

Proudfoot Commercial Agency, Inc., established in 1900, Bishops ' Service, Inc., established in 1898, Hills Reports, Inc., Hooper-Holmes Bureau, Inc., and Retail Credit Company are some of the other important agencies. Local credit bureaus have been established in the various communities throughout the country, owned either privately or co-operatively, to serve the credit information needs of their respective communities. More than 1700 of such credit bureaus are affiliated to the Associated Credit Bureaus of America, which is an international trade association of credit bureaus and collection service offices, having a total membership of more than 2600 affiliates. Records of persons moving from one place to another are tranferred from one bureau to another and a continuity of record is maintained. Collection Service offices affiliated to the A. C. B. of A. assist one another in the collection of accounts from persons located in distant places and other countries.

A question that arises logically is - why is so much credit information needed? The answer is that credit plays a very important part in the economic set up in the U. S. A. People who have to extend credit in one form or another or enter into relationships calling for certain standards of character and financial and social standing, need all relevant information on the persons and organisations they want to deal with. It is not merely the bankers who need credit information for considering loan applications. There are others who need the information too: insurance companies, mortgage houses, savings and loan associations, realty firms, wholesale and retail traders, industrial and other concerns employing personnel in key positions, filling stations and other service businesses, physicians and dentist, warehouses, national sales organisations, local state and national Government agencies and law enforcement departments. The reasons for seeking information from the credit agencies are many and varied: consideration of proposals for loans, selection of risks for insurance and consideration of claims by insurance companies under several kinds of insurance coverage, such as accident, health, automobile, burglary, fire and life, investment in bonds of local bodies and in commercial paper, sale of goods and services on credit, employment of key personnel, appraisal of management etc. The uses of information provided pertain also to such relationships as club membership, marriage situations, etc.

The sources from which credit agencies gather information are:

1. The subject himself, who is very willing to supply correct information on himself and/or his business and give even his financial statements.

2. Reporter's own observation of the subject's office, facilities, organisation, staff. etc.

3. Existing files of the agency which are useful in providing the historical background, prior connections and trade styles and other information relating to the antecedents of a subject.

4. Civic records of mortgages, suits, deeds, etc., as these throw light on the financial position of subjects.

5. Newspapers.

6. Trade suppliers of the subject can often give revealing information.

7. Correspondent in the town where the subject lives or carries on business.

8. Banks.

An interesting feature of the set-up is the willingness of the subject of an enquiry to furnish full and accurate information on himself and his business and even to give financial statements to credit agencies. The reason why people co-operate with credit agencies is that they realise that it is in their own interests to do so. Nearly every one in the U. S. A. whether in business or in a profession or otherwise, knows that he or his business is either a potential borrower or would buy goods or services on credit, or need insurance cover of any sort or invest in bonds or would want to be employed in a key position or would enter into any other

relationship where information on him would be called for. If he were unco-operative and did not give information, it would be difficult for him to get the various facilities when needed as not only information on him and his financial and credit standing would be lacking, but also there will be some doubt cast on his financial soundness and credit-worthiness, by his reluctance to give information. It is also generally appreciated that inaccurate information supplied can lead to stoppage of further credit facilities; this practically rules out the chances of any one giving inaccurate information to credit agencies.

We have no credit agency in India, at present. Banks obtain information on prospective borrowers from the subjects themselves, from their accounts, past dealings and knowledge of their character and capacity, financial statements, enquiries from fellow bankers and in business and social circles. Trade circles mainly rely on banks' reports and their own enquiries. This has worked because credit is not so widespread in India as in the U.S.A.

The economic structure of the country is, however, fast developing as a result of economic planning. The rate of production and standard of living have risen though only to a small extent. But these will rise considerably as our plans materialise. The Third Five-Year Plan will stimulate further progress. Rising production and standard of living will lead to greater economic activity, more consumption and distribution, and more credit. More instalment selling by trade and consumer loans by banks can be envisaged as more goods are produced and people getting used to a rising standard of living, need more credit. All this points to the necessity of starting credit agencies in India, if banks and others who are now extending credit and who will do so in the future to a much larger extent, are to avoid losses arising from lack of credit information. It is to be hoped a start will be made before long.

CONSUMER AND PERSONAL LOANS

BY

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The primary objective of this paper is (1) to analyse the phase of consumer credit and personal loans in U.S. Banking operations, (2) to evaluate the practices as followed by U.S. banks in the disbursement of these types of credit and the confribution of the latter to the development of the U.S. economy and (3) to examine the feasibility of introducing a system of consumer credit and personal loans by the banks in India, in the perspective of the development of the economy of India under planning. Based on experience of Indian banking conditions in the last 20 years and on the results of personal observations made during the recent study tour of the U.S. of the practices followed by U.S. banks, a reorientation of the banking system in India to the requirements of developmental planning is suggested.

U.S. Economy and Credit System

The U.S. economic system is to-day the most highly developed. With 6 per cent. of the worlds population, the U.S.A. contributes 40 per cent. to the world's production of goods. What is significant for the purpose of this paper is the high standard of living attained by the American population, in the command over articles which give comfort, status and efficiency in work-a-day life. In this society, only 18.9% of families have incomes less than $ 2,000 i.e. about Rs. 9,000 per annum. Nearly 72 per cent of all American families own at least one car 10 per cent. own two or more automobiles; 60 per cent. live in homes they own themselves; 80 per cent. own television sets and one or more radios. Despite the moderate post-war recessions, the tremendous economic growth in the U.S.A. and the consequent maintenance of a high state of material prosperity, so eloquently brought out by the economic indicators quoted above, has posed a challenging problem on the technique of planning that has made all this possible.

It is in the technique of planning in the U.S. that one finds that the integration of the U.S. banking system to the needs of dynamic growth has played a determining part in raising the level of material prosperity of the people. In common with every other aspect of planning which had, as its chief objective a higher standard of human performance, the art of credit management and the technique of credit granting within the U.S. banking system attracted some

of the best minds in banking and industry. The U.S. banking system, which is of a federal type, that is, at one and the same time national and regional, aimed primarily at making credit policy serve the demands of sustained high production, high income and high employment with a corresponding emphasis on relating the practices to meet the social habits and individual desires of millions of people who constituted the American society. The American system of credit, which on the one hand satisfied the demands of production, simultaneously developed a method of consumer financing which gave people a powerful incentive for working and seeking to improve their living conditions. Thus, the production credit and consumer credit as integral parts of the credit system have helped all along to favour the expansion of economic activities. It is recognised that prosperity in the U.S. is, to a considerable extent, the product of the extension of consumer credit. Obviously, therefore, one is interested in knowing the implication of consumer credit and personal loans and the development and progress of U.S. in this phase of banking.

Evolution and role of Consumer Credit in U.S.

In the development of the banking system in the U.S.A., as in any other country, the practice of what is called the traditional theory of liquidity was accepted as a sound principle, that is, bank loans should be for short periods and for purposes which would result in the self-liquidation of the credit such as in the production and distribution of goods. But the Great Depression and the subsequent trends in the development of the U.S. economy compelled the entire banking system to extend credit for periods of one to eight years. These credits were called term loans. With a departure from the principle of short period loans, the concept of commercial credit was liberalised to include small personal loans and consumer credit. Thus, the origin of consumer credit in the U.S. banking system should be traced to the early thirties when the banks were faced with the problem of excess funds and the public with the problem of rising out of the depths of depression. How rapid and great has been the expansion of this phase of U.S. banking can be noticed from the statistics available. At the end of 1936, there were more than 1,500 personal loan departments in banks in the U.S. and the amount of loans outstanding was about $ 500 million. Nearly 3,000 banks were estimated to grant personal instalment loans. There was also a steady increase in the ratios of personal loans to total loans, from 1.75 % in 1934 to 4.13% in 1938. Personal loans were more profitable than other earning assets and served as an effective means of supplementing fallen income and utilising existent loaning capacity. The outstanding consumer credit has increased phenomenally since the end of world war II as shown below:

	In 000 million dollars
1947	11.6
1948	14.4
1949	17.3
1950	21.4
1951	22.6
1952	27.4
1953	31.2
1954	32.3
1955	38.6
1956	41.9

The net increase of $ 30,000 million in 9 years indicates that the consumers were increasing their current indebtedness by a little more than one per cent of their spending. In the view of noted American economists, without this system, people would be more cautious in spending, but the national economy would produce less and there would be fewer jobs and more unemployment. "Despite the possibility of abuses, the system of consumer credit serves a good purpose and is fundamentally sound." The importance of consumer credit to the growth of U.S. economy is thus made clear. It is necessary to know how the banks in the U.S. operate this type of credit.

Consumer Credit Operations in the U.S.

Consumer credit in the U.S. is simply the extension of credit to the public for consumption purposes. The consumer credit was particularly developed to assist the middle-income group people. These loans are given for manifold purposes extending to every conceivable consumption need of the individual such as the purchase of household equipment, electrical applian-

ces, automobiles, television or radio sets, purchase or repairing of houses, paying doctor's bills, insurance premia or for the higher education of children etc. There is keen competition among banks in the U. S. to secure these loans, through the extensive use of advertisements, tele vision and radio programmes for canvassing consumer loans and inviting customers to borrow from banks. The experience of American bankers in these loans has been happy and this much needed service has made the American banker a true friend of the middle class citizen. Personal loans are unsecured and are advanced to individual against a down payment of the cost of goods from 10 to 40 per cent depending upon the capacity of the individuals. The loans are not to be paid out of the sale of the commodity by the borrower in accordance with the traditional theory of liquidity, nor do the banks expect to shift the loans to the open market or to the Federal Reserve Banks for liquidation. They are to be liquidated out of the anticipated income of the borrower and in this way the theory of self-liquidation is applied to consumer loans. The inherent principle is the capacity of the borrower projected over a future period in terms of employment and earnings and his integrity or willingness to repay the instalments regularly. The loans are covered by insurance which extinguishes the liability of the borrower in the unfortunate event of his death. Thus, the standard of living of the successors of the borrower is not impaired. The discount rate covers the cost of this insurance. This typical system of clean credit is termed wise mortgage of the future in the U. S., but it is in a sense self-enforced saving by the people to improve their standard of living. The effect, by an example, is that, instead of depriving themselves of desired comforts putting money aside so as to buy a house 20 years hence, a married couple buys it on credit soon after the wedding and repays the debts in instalments not much above the rent they otherwise would have to pay. Instalment credit for other goods likewise has contributed to the rise in the standard of living of people within the limits of their ability to pay. The assessment of earning capacity and integrity of the borrowers has been made so efficient through a system of individual credit reporting by specially trained executive and supervisory staff that the normal risks in this type of lending have been eliminated. The U. S. banking system has developed a creditworthiness in every person through consumer and personal loans alone. The banks on their part are placed in a position to regulate the money-flow and divert it to responsive productive channels.

Spread to British Banking System

The British banks too, long known for their conservatism in lending policies, have recognised for some years past the need for breaking fresh ground in investment policy and render useful service to those who were not fully utilising the banking system, particularly persons of small means. But no steps could be taken while the credit squeeze was in operation. With the removal of credit restrictions in 1958, the British banks have ventured into the sphere of consumer and personal loans.

Consumer Credit in Indian Conditions

It remains now to examine the feasibility of introducing consumer credit and personal loans by banks in India. A couple of banks have just (early 1959) made a pioneering effort in launching this unique scheme of personal loans for consumption needs and useful domestic expenditure, moddelled on the system in the U. S. The scheme of the Dena Bank approximates closely to that of the U. S in the procedure and practices incorporated while others advance against a collateral. It is too early to forecast how the scheme will work out under conditions of development in the Indian economy and in the background of the socio-economic base of the country, as also the structure of the Indian banking system as it has been built up. However, one can evaluate the possibilities, scope and success of this type of credit in the light of the general economic indicators of progress in the Indian economy.

India is basically an agricultural country with 82 per cent. of population in rural areas, outside the pale of the banking system. Even in the urban areas, the banking habit has hardly touched the low income groups who form the majority. But all this is changing under the concept of a welfare State and the technique of planning which India has adopted to increase the productive wealth of the country and the material prosperity of the people, at rapid pace. In the First Five-Year Plan, the primary objective was to attain a state of equilibrium in the economy, through an emphasis on agricultural production. In the Second Plan, the emphasis was on heavy capital intensive producer industries to provide the instruments of production for numerous consumer goods industries. In the Third Plan, the emphasis is likely to be on small and consumer goods industries, as a necessary base for the supply of goods that would improve standards of living which is the goal of planning. In this perspective, the banking system is to examine the role it should play in planned economic development, in contributing to the expansion of production and sustaining consumer demand for the goods produced. It has also a greater responsibility of inculcating the banking habit among the people and creating creditworthiness

which can be done only by a bold, yet cautious policy of gearing credit programmes to the changing pattern of demand in production and consumption. It must not be forgotton that, considering the huge population of nearly 400 millions comprised in more than 5 1/2 lakhs of villages and the dominance and grip of indigenous agencies in supply of credit, the task of developing banking is of great magnitude. But this has to be done, if Planning is to succeed in lifting the population from the morass of poverty. And the reorganisation of the credit system alone could act as a catalytic agent in raising levels of production and consumption. The writer, therefore, believes that it is none too early on the part of organised banks to depart from conventional practices of lending and introduce a system of credit which is the determinant of national prosperity in U. S. economy. Even the Governor of the Reserve Bank of India has felt that need for reform in conventional lending policies of banks in India. The system of consumer credit to be followed under conditions of dynamic growth is also a major reform in the lending practices of banks.

There is one other fact to be noticed under the conditions of economic change. The deposits held by the banks have been increasing and, for the first time since the end of World War II, have outpaced the active circulation of currency. This is a healthy sign in the development of banking habit in the country. But even so, the ratio of deposits to currency is far below the trends in advanced countries. In the U. K., the bank deposits were about three times the volume of currency, in the U. S. A. about six times, in Germany about 4-1/2 times, and in Ceylon, our neighbour and an underdeveloped country, there was a much larger volume of deposits than currency. The inference is that, while deposits grow, there should be important outlets for bank investment which should serve the purposes of planning.

Consumer Credit and Inflation

The one objection to personal loans and consumer credit arises from the fear that it is inflationary in its impact on the economy and, under Indian conditions of goods in short supply, the system would aggravate the effects of inflationary pressures already in sight since 1955-56. The position will have to be clearly perceived. Indian economy is underdeveloped and is in the process of rapid growth. Secular inflation is a sign of economic growth and is inevitable; it is desirable if it stimulates production. This type of inflation should be distinguished from runaway inflation of an emergency period as during a war or a monetary disaster. The danger of inflationary fear to-day is the result of the instability in our agricultural production and prices. It is only under conditions of maximum peacetime employment and national income, it would be economically unsound to encourage consumer credit; not under conditions of dynamic growth when production is to be stimulated. The regulatory arm of the State is always there to bring about necessary adjustments under conditions of galloping inflation, which has no relevance in the state of development of our economy. With a drive for increasing production, consumer credit represents new effective purchasing power which will sustain the tempo of production from plan to plan. Therefore, consumer and personal loans are not inherently inflationary as to disturb the maintenance of sound credit conditions, both as to the individual institution and the economy generally. While no thinking person, least of all a banker, could minimise the evils of inflation, it is recognised that consumer credit is not the primary creator of inflation and, therefore, the cure cannot be effected through that means alone. The cause and cure of inflation have many facets and any partial attempt to tamper with one secondary factor alone would only serve to create further imbalance in the economy.

Under the conceptions of socialistic pattern of society and welfare State, there is the shift in income groupings and we have already a sizable middle-class population who are and will be the backbone of Indian society. The scheme will be beneficial to the growing middle class people. They will be unable to acquire the amenities of an improved standard of life except by an enforced saving scheme such as consumer credit.

In conclusion, it must be admitted that the personal loan scheme has the following main advantages: (1) It is a beneficiary loan helping customers to equip themselves with the ordinary comforts of life or to make a start in business or profession; (2) It contributes to the Plan objective of improving the standard of life of the people; (3) It creates effective consumer demand for goods which are not within the reach of the fixed-income or low-income group; (4) It assists in the stimulation of production; (5) It is a potent instrument in levelling up the members of the society and thus conform to social equity; (6) It acts as a lever to the banking system in modifying the practices to changing needs; And (7), but not the least, it makes the people creditworthy and credit-conscious. The writer would, however, suggest that the procedure and practice of granting these loans should be suited to Indian conditions. Firstly,

until the banking system in India is able to have an opportunity for accurate credit inventory of the clients, the executives and officials should train themselves in the three major functions of acquisition, analysis and dissemination of credit information of the clientele. Secondly, in the type of loans granted, the banks should look to the disabilities and needs of Indian population, as house purchase or repairing, education of children, building up of sizable insurance, etc. If only the rural population is made bank-minded, their dependence on indigenous agencies will diminish and much of the unproductive expenditure will find a way into the purchase of useful goods for the household. Thirdly, credit agencies could be established in due course to cover the largest part of the population, through Bank Association. These could serve as the effective channels for credit reporting. Fourthly, it would be in the interests of sound credit if the Life Insurance Corporation could co-operate with banks in providing insurance cover for the borrowers at a cheap rate and Government aids by simplifying the rules for allowing the interest on personal loans obtained from banks as a deductible item for purposes of income-tax.

While, initially, the scheme may seem costly and tedious in administration, it is sound in principle and is necessary to be implemented with the growth of the economy. The contribution of consumer credit to the U.S. economy has been tremendous. Under conditions of growth in the Indian economy and the future of bank credit, it will be helpful, safe and profitable and it must be allowed to grow and expand in its proper relation to our national economy.

INDEX OF QUESTIONS

SUBJECT MATTER OF QUESTIONS REFERRING TO PAPERS PRESENTED BY THE SIXTEEN BANKERS ON THE PANEL

	Subject Matter	Question Number
I.	Portfolio investment by banks; government cooperation with private banks. T.K. Ramasubramaniam; K.N.R. Ramanujam	1, 2, 3, 4, 5, 6, 7, 8, 9,
II.	Joint Loans V.C. Patel	10, 11, 12, 13,
III.	Investigation of loan applications, collateral and assistance by banks to borrowers. R.P. Chopra; S.V. Chandavarkar; B.N. Mehta	14, 15, 16
IV.	Credit agencies, Credit investigation by banks and exchange of information. M.G. Parikh; K.S. Chaturvedi	17, 18, 19, 20, 21, 22
V.	Promotional and advertising activities by U.S. Banks; bank arrangement. A.L. Sathappan; K.D. Shandilya; C.S. Venkat Rao; Ram Rakha	23, 24, 25, 26, 27, 28, 29, 30
VI.	Follow-up by lending banks after a loan has been granted. Deposits and lending procedures. M.G. Parikh; V.C. Patel, P.K. Sen; R.V. Pandit	31, 32, 33, 34, 35, 36, 37, 38
VII.	The role of the Federal Reserve Banks in U.S. banking S.K. Pandya	39, 40, 41, 42,
VIII.	Consumer credits and personal loans. P.V. Gandhi	43, 44, 45.

QUESTIONS AND ANSWERS

[The following questions and answers are taken from the discussion periods which followed the presentation of each four papers by the participating bankers. For purposes of clarity and and because of lack of space, the questions and answers have been categorized and edited, and although in many cases the answers were given by the speaker to whose paper the question is directed, statements by other members of the panel and participants in the Seminar may be included. The numerals in the left margin indicate both the numerical order of questions and answers and the division of the questions into broad categories. An index to the subject matter blocks may be found on page. ___ Ed.]

I-1. Q: (Directed to the paper of Mr. T.K. Ramasubramaniam)
To what degree do United States Government banks and financing agencies compete with similar private instituions? How do they cooperate with private lending institions?

A: Government financial agencies in the United States do not compete with private capital, do not compete with private banking institutions and any other lending institutions. They are there to fill up gaps in the financial structure which private agencies have left uncovered. For example, let us take the requirement of a small business manufacturing concern. It may require funds for working capital, purchase of equipment or plant, or for the purchase of a factory building, etc. It may go to a bank, but the bank might after consulting various relevant factors such as its performance, its assets and liabilities, and all other considerations, not feel quite confident about the proposal and might turn it down. In that case, the United States Government have ensured that there is some agency to which this small concern could go and attempt a re-appraisal of its proposal, so that if on a re-appraisal it is considered eligible for a loan, the loan is given. That is, the Small Business Administration is a sort of last resort institution which does not compete with any one else. But the essence of participation is there. A party, first of all, may go to a private bank. This bank might decline the proposal. Then he goes to the Small Business Administration. It might tell the party to go to the bank again, and ask the banker whether he would be prepared to give the advance in this case, i.e., on a participation basis with the Small Business Administration. The bank might, on that basis, be willing to consider the proposal because the SBA might be willing to practically guarantee the risk to the extent of 90%, the bank's portion being limited to 10%. In that case, the bank would lend its own money and would process their own application, and merely advise the SBA that the arrangement had been made, and that on notice by the bank, the SBA should pay that portion which is not alloted to the bank. In many cases, although arrangements have been made for participation, the bank will bear all the financing. They may never actually call upon the SBA to make good the portion underwritten by it.

I-2. Q: (Directed to the paper of Mr. T.K. Ramasubramaniam)
Is there any competition between government financing agencies and the commercial banks with regard to accepting deposits from the public?

A: In the case of three specific government agencies, the SBA, the Export-Import Bank, and the Development Loan Fund, none of them accept any deposits from the public. All of them get their funds by appropriation, by authorization from the Congress of the United States.

I-3. Q: (Directed to the paper of Mr. K.N.R. Ramanujam)
In the light of present-day conditions in India and the techniques being adopted by our banking system, would it be desirable for our banks to invest a portion of their funds not merely in bonds of first-class concerns but also in equity shares?

A: The practice has to be commenced by the banks which have large resources in India. And initially they should have some sort of a ceiling limit related to their capital reserves, and the time liabilities. And up to that extent these big banks should invest not merely in bonds but also in equity shares. But it depends what the ceiling limit should be. It would naturally vary from bank to bank depending upon their other asset structures. But I think a stage has come when some of the bigger banks should proceed on these lines.

I-4. Q: (Directed to the paper of Mr. K. N. R. Ramanujam)
Would it be desirable for Indian banks to invest only in equities of well-established companies with good mortgage quotations and whose past performance has been excellent? Or should the banks also invest in shares of new companies, i.e. new equities?

A: I think at this stage when we find that investments of banks in equities is very insignificant, that the preliminary attempt should be investment in well-known companies whose dividend records are good. One could set up certain creteria depending upon the bank's own initiative. Therefore, at the moment the investment should be confined; it should not extend in respect of new companies, but only to companies which are no douot quoted on the stock exchange and where their dividend record has been good and where they are well-known for their sound management policies. Initially it should relate to companies of that nature.

I-5. Q: (Directed to the paper of Mr. K. N. R. Ramanujam)
Should investment in equities of new industries be left to specialized financing agencies like the Industrial Credit & Investmer Corporation of India, Industrial Finance Corporation, and State Finance Corporation?

A: Yes. For the time being I think we will have to go slow, depending upon experience. Since there are already these other long term financing agencies my own personal view is that for the time being the banks should leave it to these new concerns which are equipped to handle this kind of equity investment.

I-6. Q: (Directed to the paper of Mr. K. N. R. Ramanujam)
Would it be undesirable, at this stage, to establish a consortium of banks and insurance companies as suggested in the Shroff Committee Report to underwrite, invest in, and subsequently market equities of newly established companies?

A: The Shroff Committee made the suggestion for a consortium related to facts which existed at that time, and which have changed since then: (1) the nationalization of the Imperial Bank; and (2) the nationalization of life insurance companies, Nonetheless, even today if the bigger banks want it I do not think anything should deter them from coming to some such arrangements.

I-7. Q: (Directed to the paper of Mr. K. N. R. Ramanujam)
Since the Life Insurance Corporation is a very large investor in the market, there has been a scarcity of good investments in equities of well-established concerns, hence the prices of these shares have been pushed up. If the banks were also to enter this field would that not further complicate matters?

A: The idea here is that as we proceed the demand for industrial credit would be so large that it is not a question of the banks competing with others for existing shares. But they would be in a position to take up more and more new issues which are offered in the market. The kind of situation referred to here arises only if there is an agency to compete for the shares which are already quoted in the market. But what I have in mind is, as companies, some of the existing companies want to expand their operations and they come to the market and offer new issues. These agencies must give assistance in subscribing to the new issues. This will not bring about the kind of situation which is envisaged in this question.

I-8. Q: (Directed to the paper of Mr. K. N. R. Ramanujam)
In the U. S. the Federal Reserve Banks lend to member banks against acceptable assets. The Reserve Bank of India is not empowered, under the existing Reserve Bank of India Act, to lend except on certain 90-day bills or in emergency cases. Would it, therefore, be advisable that the Reserve Bank should change its policy and make advances on other assets as well?

A: Under the existing Reserve Bank of India Act there is a provision for the Bank to make loans against acceptable assets, but only in emergency. That provision already exists in the Reserve Bank of India Act. The question whether the bank should extend its portfolio of securities against which it should lend, should be based upon the practices which other banks follow in the creation

of such sound assets. And as and when the practices are such that the bank would safely lend, the Reserve Bank could enlarge. The action of the Reserve Bank should follow the policy which the commercial banks are adopting in this regard. It can only follow the action of the banks and cannot precede it. It is for the commercial banks to create the type of sound assets which make it possible for the Reserve Bank to extend the portfolio. The initiative should come primarily from the commercial banks.

I-9. Q: (Directed to the paper of Mr. K. N. R. Ramanujam)
Is there in U. S. banking practices an advance-equity ratio which is insisted upon by banks? For example, if the enterpreneur can find 25% of the capital for a new venture, will the bank find the remaining 75%? Furthermore, what type of facility should be provided in India to help a small man to get started? Can the bank do this or should it be a new body or investment house? Assuming of course that capital is required in the first instance before the banks come into the picture with their loans.

A: The question is one of ratio. It varies from bank to bank in the U. S. The kind of association indicated is present more on a regional basis rather than on a national scale. It is more on a regional basis where the character of the enterpreneur is well-known and it is in the category of some of the character loans which have been discussed. The position in the U. S. is much different because there is a really effective and active capital market and the banks come in only by way of financing at intermediate stage, from the time the thing is established until the capital is issued in the market. For a small man in India help must come from institutions which are already established and which will be set up depending upon the need. It is only they who can fill the need. And so far as the banks are concerned, they must do it in collaboration with other agencies because the proposition has to be looked at as a whole. What are the total credit requirements of a small business? What part of it is in the form of working capital and what part of it in the form of long term capital? The total view is taken and the participation of the banks and long-term credits from other institutions is worked out. Then only can the bank actually come to the aid of such a small man. The bank cannot operate in isolation from other agencies in the field. At present, banks cannot provide equity capital to small industries, but if these new institutions which have been started in various states undertake loans in collaboration with the banks, by guaranteeing the advance, then banks can very well process loans, which can be used for equity capital.

II-10. Q: (Directed to the paper of Mr. V. C. Patel)
Is there any law in India, or prevailing banking practices, by which development of participation loans are not permitted? Could it be lack of cooperation or personal jealousy between various banks which prevents our banks from making participation loans?

A: There is no law as such which prohibits the banks in India from making participation loans. I do not think that the reason is jealousy. That kind of financing has not yet been developed to a very great extent in India. Of course, some banks make participation loans to a small extent at present when there is a very large advance to a single borrower. So I think that it is mainly because of the way in which our banking system has developed that there have so far not been participation loans to a very great extent.

II-11. Q: (Directed to the paper of Mr. V. C. Patel)
In the light of the low idle reserve position of most banks, is there much opportunity for "participation lending" to be developed in India? If so, how?

A: I do not see what the reserve position has to do with participation loans. We are only considering here a number of banks joining together, each putting in something, and facilitating a fairly sizeable loan being given to, let us say, an industrial unit for purposes of legitimate expansion. Let me give an example. When I was in the United States, I learned that Henry J. Kaiser Corporation wanted a loan of 50 million dollars for expansion of their steel mills. That was beyond the means or beyond the prudence of any one single banker to provide. It is a huge sum. What was actually done was that seven or eight banks joined together, each putting up 5 to 10 million dollars, and the sum was raised and one single agreement was drafted by the Henry J. Kaiser Corp. in favour of all the participating banks. All the covenants, the conditions, and the allocations of security, were set out in that document, and one of the banks was appointed as agent for

all the participating banks. It dealt with the advance on behalf of all the banks and that arrangement has been working very well. That is only typical of many such instances where loans are given on a participation basis. They are given essentially from deposit reserve.

II-12. Q: (Directed to the paper of Mr. V. C. Patel)
Could you explain the machanics of participation loans? When one bank is appointed as the agent for all participating banks, how does this agent-bank recover its charges and how frequently does the bank present progress statements to the participating banks and what other responsibilities does the agent bank have?

A: A participation loan of a fairly substantial size is not given without the most careful investigation of the company's borrowing units, past performance, its future earning power, the quality of its management and above all the character of the men behind the venture. The most important factor is the integrity of the persons who are behind the venture. If there is any doubt at all on that factor, the loan is summarily turned down. The two major factors in U. S. banking so far as the long term is concerned are (a) assessment of the character, that is the ability, of the management; and (b) the future earning potential. If the participating banks are satisfied on these and if because of the minute examination of the balance-sheet, profit and loss account, and other statements, it is found that the borrowing unit is a sound unit, there is nothing adverse in its operations, it is maintained on a satisfactory ratio, let us say between current assets and current liabilities, between its sale proceeds and its expenses, and it is not following any extravagant policies in matter of declaring dividends, it is ploughing back a good portion of its earning into the business, that its management is first-class, it can be relied upon to repay the advance, then the banks come in for participation, and not otherwise. Security is perhaps a last consideration. In New York, I think, I am pretty safe in saying the banks do not look with favour upon securities. But in smaller towns and communities there is greater emphasis on securities and less emphasis on the purely unsecured aspect of the loans. You do not have the same standard of performance, the same standard of repaying ability which you can expect in bigger places like New York. In participation loans, the essential thing is that first there must be a frank and free conversation between the borrowing unit and the bankers about what a borrowing unit would do. Let us take again here by way of example the case of Mr. Kaiser. He would go first to his own banker and put before his banker what exactly he wants to do, his proposals for expansion, the problems he is facing, and why he wants banker's assistance, and so on. The bank would listen to him carefully as a friend would do. It would examine all his statements and see then if it is satisfied that there is a very good case. Now, for a number of banks to participant, it would arrange for a conference of other bankers, may be six or seven operating in the same city. And then in the conference again Mr. Kaiser goes there probably with his attorney and accountants and explains all the facts of the case and questions are asked. If the conference of bankers is completely satisfied with the proposal then they undertake to finance him up to the extent required. Here I must point out that there is no question of banks refusing to give the legitimate requirements of the borrowing unit. They either give what he wants or they do not give at all. Thus, if a party wants 10 million dollars they do not bargain and try to cut it down to 5 million. They agree to give 10 million if there is a case that he wants 10 million, 9 million would be useless to him. They either give 10 million or they do not handle the loan. When they do participate, the participation is based on the reserves and the commitments of individual banks. There is no law on the subject. And then a single document is drafted between the borrowing unit and the participating bankers. One bank is appointed as the agent, it handles all the documents, and it undertakes to receive financial statements. Financial statements are insisted upon every quarter. The borrower has got to place before the agent-bank every quarter a full statement of his earning, his expenses, his sales, his purchases, and pertinent information, his profits and so on. Sometimes even monthly financial statements are required. And in addition the banks may also call upon the borrowing unit to supply them with periodical supplementary information on any aspects on which they may have doubts, or they may seek clarification. It is a question of mutual cooperation all the time, mutual good relations and confidence being the basis of the whole arrangement. The security aspect is least important. The whole arrangement is based on mutual cooperation, mutual desire to be helpful and absolutely fair. As regards recompense there is a rate of interest on the loan which is related to what in the United States they call the prime rate. It all depends on the parties, as it is in India. First class parties can get a rate of 4-1/2% or may be 5% and that is all the recompense. This 5% the agent bank receives along with instalments. The loan is repayable in each case in instalments, may be monthly or quarterly as the case may be. But I think monthly is more popular than half-yearly or annually as it is in India. These instalments are recovered by agent banks along with interest, and are subsequently distributed prorata to each bank in accordance with its participation, and if a participating bank wants any particular information from the unit which the agent bank is unable to supply from the records

it receives periodically, it arranges to get this information from the borrowing unit. In other words, the agent bank is the lending bank so far as the borrower is concerned. The agent bank is the trustee for the other participating banks.

Ambassador Bunker, commenting on this question, said: "I think Mr. Ramsubramanium has given a very clear explanation. It has been my experience that very frequently the managing bank makes no charge for its services. The group is formed and one leading bank might take the lead in it. But there are other ways also in which it is done. I can say from my own experience for example. Several times I borrowed on term loans where I wanted to acquire other businesses. Sometimes this was handled through principal banks, and sometimes with a group of banks individually. For example, I want to borrow 10 million dollars and I want to borrow 5 million dollars from 'X' bank, and I am going to borrow so much from another bank and from the group. I dealt with banks individually, and the procedure has been, at least in my experience, quite simple, and the decisions quite rapid. And I think that where you find a client has been doing business with the bank for over the period of years, the problem of participation loans gets to be quite a simple matter. Our usual practice I think was of simply submitting quarterly statements of earnings, of lending banks to make payments directly, individually, to the banks who were members of the group and the whole procedure was handled in a very simple manner. When you get into loans of the size of Kaiser, as Mr. Ramasubramaniam said, for an expansion program or something of that kind, of course you do get into much more detail. Projections of earnings and details of balance sheets and so forth are obviously necessary as well as the legal aspect of it. In very many cases very substantial participation loans are made, I must say, very rapidly and with a very simple procedure."

III-13. Q: (Directed to the paper of Mr. V. C. Patel)
Is it not because there is unit banking in the U. S. that participation by banks in big loans has been successful? In India we have a branch banking system and since all big banks happen to have their branches in a particular place, a customer is able to meet his requirements by getting credit loans from different banks. Should, therefore, branch banking be replaced by unit banking for the adoption of the policy of participation loans? Or could banks with their present structure entertain this kind of business?

A: No doubt in the United States participation loans originally started from the nature of the structure of U. S. banking. But our present system of branch banking does not in any way impede that sort of participation lending if we what to do it. So there is no necessity for changing our bank structure of branches into unit banking. Even at present the banks could grant participation loans where an individual bank considers that a particular advance is too large for it. It can share with other banks. So there is no necessity for changing the bank structure. The question is the size of the loan and how the individual bank feels about it. No statutory limitations exist in India and each bank can have its own view of how much risk it will take in respect of individual loans. Since we are tending towards a state when there will be large industrial demands, the loan amount will be for large sums. It is in such cases that the banks would come together, and the need for cooperation in development of participation loans has nothing directly to do with the structure of banking as such. Experience with various banks in India shows that it is not structure of banks in India that needs changing. It is the outlook of the banks that needs changing.

III-14. Q: (Directed to the paper of Mr. R. P. Chopra)
How can a credit agency obtain authentic information? Should this be supplied by the loan applicant and by other sources, though the information supplied by the applicant may not always be authentic?

A: It is very essential for the banker to have all kinds of information about the borrower before the advance is made. The banker should satisfy himself about the credit-worthiness of the borrower, about the properties, and all those things which he is maintaining. This information is obtained from the borrower and also from other, independent, sources.

III-15. Q: (Directed to the paper of Mr. S. V. Chandavarkar)
In the U. S. practically all advances are made by way of loans and not by way of cash credits or overdrafts as commonly done here in India. In the U. S. the absence of security is no bar to obtaining a loan. What sort of loans are these? To what people and under what circumstances are unsecured loans given by banks?

A: Such loans may be made to manufacturing concerns. The bank knows the firm has a certain earning potential, that assets are there, and does not insist on the assets being mortgaged. They know that the company can repay from earning potential. Such cases are very very frequent. The vice-president of a Wall Street Bank said that if he could not give an unsecured loan to a party he would prefer not to give a loan at all. Security consists of character, ability, management, earning potential, and past peformance. All these things are considered. But security is not ruled out altogether. About 80% of the loans given by the banks in the United States are unsecured. Some of the biggest banks in the United States say they would rather not worry too much about security. That is typical of the American philosophy. By and large the rule which the American banks observe is that if an industry cannot repay its loan, the security it has to offer is not worth having.

III-16. Q: (Directed to the paper of Mr. R. N. Mehta)
What does the Uniform Trust Receipts Act in the United States entail?

A: As regards the Uniform Trust Receipt in U. S. A., suppose for example, certain goods are lying in a certain warehouse, and they belong to "A". The warehouse keeper will issue a receipt in favor of "A", and if "A" wants to borrow money on the security of the said goods he can endorse receipt to the bank or any other person. It will constitute warehouse security so far as lender and borrower are concerned. In India we have something like the Trust Receipts. For example, a borrower takes money against security of goods from some bank and if he desires to sell the goods he can take back the goods from the bank and hold the sale proceeds of the stuff for the bank. That is the usual Trust Receipt according to the procedure in India. In the U.S. the bank can make a valid advance and the Trust Receipt is considered as good security. This is not the position in India because in the U.S. there is also a provision for the registration of the Receipt. There is no similar provision in India. If some sort of provision is made in India which would enable the registration of the Receipt as well as amending the insolvency law whereby the doctrine of ownership would not arise in case the goods are handed over to the borrower for some specific purpose, the banks can get definitely better security.

IV-17. Q: (Directed to the paper of Mr. M. G. Parikh)
It is mentioned that all partnership firms should be compelled by a law to have their accounts audited. Would it be desirable for the banks themselves to insist on audited balance sheet in case of loan applications instead of waiting for the law to compel them? And could this be achieved if all the banks tried to insist on it?

A: If a banker wants such information he can get it only from the client. A banker will usually ask a loan applicant for a statement showing assets and liabilities, and a profit and his loss account. These will not be audited and therefore the bank has to check the information carefully. For the banks themselves to insist on audited balance sheets in the case of partnership firms may be rather difficult.

Financial information provided by a borrower in case of a loan application in India is often very evasive and incomplete. The reason for this is that the information given regarding one's financial standing in this country, even when it is passed on in confidence to a bank, can be called upon by the income-tax authorities under the law. This is not possible in the U. S. A. There just the opposit is the case, the income-tax department gives information to the banks, but the banks cannot and will not divulge any information regarding their constituents to the income tax department even if the client gives his permission.

Here under the law the income-tax department can force you to open up your books and show all that is in the accounts of your constituents, which in the United States of America can only be done under write by the Federal Court of Law.

IV-18. Q: (Directed to the paper of Mr. M. G. Parikh)
Though every good bank collects credit information on its customers, Indian banks are reluctant to share this information with fellow bankers. Could the reason for this be that good business is limited and the fear of losing a good account to a competitor is very real, or could it be that the Bank Reforms Act should be revised to the effect that exchanging information among banks does not amount to divulging a client's secrets?

A: The banks do have their credit departments, but at the same time the information which the banks have in their own departments is not complete. As regards this fear that the banks would lose business because good business is very limited, it is a debatable question. I think good business is plentiful. In a developing economy like ours business is growing fast and industry is growing fast, hence there should be plenty of opportunity for the banks to advance.

Resulting from our contact with British banking, we in India perhaps follow the British practice of not sharing information. There is probably room for some improvement in developing exchange of information. Though it is common in most banks to exchange information about clients, the answer is given in very guarded language and exact details are not divulged but there is no need for having any legislation on this point. The question of a bank's confidential reports on customers is a very ticklish one and most banks experience considerable difficulty. The reluctance on the part of bankers to divulging information about their customers based on running the risk of business being diverted to the other bank is being very petty. Inquiries are made for very genuine purposes and a banker has every right to make inquiries from the customer's ex-banker or the present banker; the latter is in turn responsible to say accurately what he thinks of his client. Especially in the case of out-station customers who particularly mention a certain banker as reference, this banker should then unhesitatingly give his report in the best interest of the business as a whole.

The worst offenders with regard to exchanging credit information are the branch banks in rural centers. It is there that the amount of jealousy is felt most keenly when an inquiry is made, but most inquiries are as a rule perfectly harmless.

The usual form in which information is given by one bank to another is in two sheets. The one, quite non-committed, is in reply to the inquiry of the other bank and on a separate bank sheet the additional information is given. This is not signed and the name of the bank is not given. That safeguard is adopted as a matter of practice. I do not think there is very serious risk of any litigation. As has been expressed, there is some fear of losing business. No doubt, but there is also a risk in not disclosing information. There have been many cases in which banks have advanced sums on the same security placed with several other banks. If they had exchanged all information, probably they would have saved themselves from getting into difficulties. I would like to suggest that two important steps could be taken: (a) the building up of a code of ethics helping the banks to play fair with each other in exchanging information and give as much comprehensive information as possible on the strict understanding that the inquiring bank will not make any unfair use of the information divulged; and (b) the building up of a suitable credit investigation organization like Dun & Bradstreet. But these two activities cannot properly be taken up by the Indian Banks Association. It has been suggested that the Reserve Bank should undertake collection of credit information, but no central bank of any country does this. However, there have been instances where the central bank of a country collects information on the total outstanding credits extended to individual parties. The central bank in Germany, for instance, publishes periodically the outstanding loans of some of the bigger corporations which naturally gives general guidance to the banks dealing with those corporations. That is the kind of thing which might be worthwhile for the central bank to consider; a periodic publication of information regarding total indebtedness of certain parties.

In the absence of any detailed information being available even this information is useful. It is more of a statistical type, giving only total limits without giving the banks' experience or the conduct of the parties. Recently there has been a good deal of fraud which has had very serious repercussions on the country's economy. Such a thing might have been averted if information about a particular borrower had been passed on to the various banks. They would have been more careful and overtrading could, to some extent, have been avoided.

IV-19. Q: (Directed to the paper of Mr. K. S. Chaturvedi)
Establishment of a Credit Investigation Agency in India is suggested. Could this be established as (a) a private business operation such as Dun & Bradstreet, or (b) should it become part of an organization such as the Federation of Indian Chambers of Commerce & Industry, or (c) preferably an independent non-profit corporation?

A: It would be most appropriate that such an agency should be a private body which might work on a profit-making basis as Dun & Bradstreet is doing in America. The beginning would have to be very modest and the agency should confine its investigation to businessmen who would be more inclined than others to give information about themselves, knowing that such information would be needed by banks and other people.

IV-20.Q: (Directed to the paper of Mr. K.S. Chaturvedi)
Will a private credit investigation agency command the confidence of the business people so that they are likely to report to them.

A: In the beginning there might be difficulties on this score. The agency would have to fight against distrust and similar things, but in the long run, by honest work and good service, they could win over people and get more and more information on businessmen. We cannot just impose a Dun & Bradstreet organization in India overnight. It is quite impossible to do that. We must make a humble beginning by all banks pooling their information on parties and building up a credit file on each party. The developments which come to the notice of any bank regarding a party should be passed on to a central organization. This would give you a nucleus upon which to build. The next stage would be to enlarge its operations by getting independent information and by having some kind of credit agency organization. We should also send intelligent young men from India abroad to organizations like Dun & Bradstreet to be trained in the techniques of credit information.

IV-21.Q: (Directed to the paper of Mr. K.S. Chaturvedi)
Is there a law protecting information bureaus or agencies from prosecution if they disclose and make public unfavorable information with regard to various people?

A: Information supplied by credit agencies is on a confidential basis. The contract between the credit agency and the inquiring bank stipulates that the agency is employed by the inquiring bank as its agency, and the information is being supplied by the agency as an agent of the employer, and the information is to be treated confidentially by the inquiring party, and it is not to be disclosed to any person. This is faithfully observed by banks and other inquiring parties. There have been cases where information was disclosed and the party who divulged information under these conditions had to suffer the consequences. The competition between banks is such that if a client feels that one bank is troubling him very much or probing too much into his affairs, he goes to another bank. So the banks must get together and must have some uniform attitude about these matters. We must standardize our loan application forms and other forms so that on that account we do not lose customers. Bankers should get together and have some uniform attitude about these matters.

IV-22.Q: (Directed to the paper of Mr. K.S. Chaturvedi)
In addition to providing credit information, Dun & Bradstreet also publishes their famous big book which is available to all subscribers without restriction. How can this information be termed confidential? Can Dun & Bradstreet be held liable if it reports adverse information about a company?

A: The reference book is revised every two months and it incorporates the various changes taking place. This book can be bought by any bank or any other party. The information given in this book is about the general background and the constitution of the firm, the capital of the company, etc., and it would not usually contain anything that might lead to an action for libel. It merely gives information about the various parties listed therein. If you are a company or an individual you are asked by Dun & Bradstreet to make a report. The information which you give is entirely on a voluntary basis. There is no law that requires you to file anything with Dun & Bradstreet. If you do not file anything all the service will ever report on you is that no report is available. So you draw a complete blank in the book. The book gives primarily, in simple interpretation, the financial rating as far as capitalization is concerned and the credit rating as to the ability to pay bills. If you are a subscriber to the Dun & Bradstreet services you may receive individual reports on any company. The only other thing which will be covered in those reports is what is public information either through filings with the Securities and Exchange Commission, or public records of law suits, or public records of mortgages having been made or given. So they report only that which is given voluntarily or that which is published in the public record. They are not liable in their reports to give any adverse thing which is not a matter of their own record or the public record.

V-23.Q: (Directed to the paper of Mr. Ram Rakha)
What role do U.S. banks play in helping new enterprises to get started?

A: The banks do not actually help new enterprises financially in getting started except in cases where banks are associated in connection with regional development. In such cases the banks are associated in participation with other long-term lending agencies, and they play an important role. It should be possible for the banks in India to do the same provided it is done on a participation basis with other long-term institutions or development corporations.

V-24. Q: (Directed to the paper of Mr. A. L. Sathappan)
Can you clarify the concept of School Savings Accounts?

A: The Bank of America opens accounts in the names of school children. The bank's representative goes to the school, twice or thrice a week, and receives remittances and credits them to their respective accounts. The passbooks are delivered to the school children. The accounts are opened in the names of minors, but a letter of authority is taken from the parents. They are authorised to operate the account only after getting a letter of authority from the parents.

Mr. Houston, commending on the question, said: "This whole school saving scheme is a very interesting program in the States because it encourages saving at a very early age in public schools, by which we mean government-owned schools. There is a great deal of encouragement to children to save, and I think it is a good idea. It is something which the bankers should be tremendously interested in all over the world. The Scandanavian countries do a very good job on this too. When I visited there some years ago, I found very much the same system."

V-25. Q: (Directed to the paper of Mr. A. L. Sathappan)
Banks in the U. S. advertise collectively. Is it done through the media of the American Banking Association to change the public attitude towards banking in general? What are the details of this collective advertising? What are the methods commonly used?

A: The system is used to develop a better public attitude towards the bank, and towards the bankers individually. U. S. banks have associations of banks and they have various levels of goals that they want to achieve. One is the idea of savings. They have gone out and publicized this broadly, talked about various measures, which I think may be very applicable to India, to increase savings generally. As a group, the bankers introduce legislation or oppose legislation which they do not like. An American bankers association would have an assessment and they would have a part of their budget for what we call institutional advertising. Banks on a certain day might say, "We are worried because bankers in general are under suspicion in the United States." This is an attitude which the bankers think is incorrect, and they want to change public opinion in this matter. Then they could easily have a special levy prior to hiring advertising experts and launching an enormous national campaign to try to make bankers more popular. That kind of thing is quite common not only with banks, but also with insurance companies.

V-26. Q: (Directed to the Panel)
In the U. S. the banks train their personnel intensively to cultivate the goodwill of the customer, how is this done? Are special courses given?

A: In the United States the American Bankers Association runs courses through various colleges, and the broad area covered by these courses is really of great interest to many of the people who work in the banks. These courses attempt to give the employees of the bank a picture of the total economy, the general area of management, and the ability to cope with the language of the people that they will be coming into contact with. They need to understand what a production manager is talking about if a question is raised in that area. So there is an attempt to broaden the view of bank employees, and one of the areas to which this is devoted is public relations.

V-27. Q: (Directed to the paper of Mr. K. D. Shandilya)
How can the suggestion that more technical services are needed, be implemented in India?

A: Here in India we have been confining ourselves mostly to financial assistance with regard to loans. We do keep touch with the borrower to ensure that his financial position does not deterio-

rate or that the safety of our advance is not endangered. But very little is done to have the borrower improve his working or techniques. Bankers in New York know exactly what is happening in a concern. They pay visits to these concerns very often and thus come to know exactly where and how things can be improved. We can do the same thing here. We must know more about our borrowers. It is not sufficient just to ensure that our advances are safe and that their financial position is not deteriorating. We can employ specialists to value property and their services can be utilized in other directions also. Bankers, with their experience, can at times help borrowers to find out what their faults are.

V-28.Q: (Directed to the paper of Mr. C.S. Venkat Rao)
Are trade unions in banks prevalent in the United States?

A: There are no trade unions in the American bank system.

V-29.Q: (Directed to the paper of Mr. C.S. Venkat Rao)
In branch-head office relationship in the United States the District Operating Officer, who is a sort of supervisor, has no loaning powers. Do loan proposals of branches pass through this officer, giving him the right to give his comments? How large a staff do the District Operating Officers usually have?

A: No. They have no right even to comment on the loans. That is a direct matter between the branch manager and the head office. District Operating Officers deal only with subjects other than loans. He usually has a crew of about half a dozen people.

V-30.Q: (Directed to the paper of Mr. C.S. Venkat Rao)
Between 1921 and the end of March 1933, over 16,000 U.S. banks with deposits of over 9,600 million dollars, suspended payments. Between January 1, 1930, and March 15, 1933, alone 5,492 banks with deposits of over 3,500 million dollars closed their doors. Were these failures due to dishonest or illegal banking practices of the management? Has the American system grown so strong in the last quarter century that it has become immune from a calamity of this nature and can be called the Eighth Wonder of the world?

A: The events referred to took place when the banks were in a state of crisis. That period is now gone and it is not likely to be repeated in future. Also there are one or two things that have happened in between. One is the control that the Federal Reserve has over the banking system which enables banks to have a certain amount of liquidity which they did not have previously. Secondly, the Federal Deposit Insurance Corporation was established and it also ensures the deposits of individuals up to about $ 10,000. These are things which were not existant in the period to which referrence has been made, and which make all the difference, and it would be correct to say with some justification that it is a kind of Eighth Wonder of the world.

VI-31.Q: (Directed to the paper of Mr. M.G. Parikh)
Advances given in the United States are in the form of loans as opposed to our form of cash credits. Could this system also be adopted in this country?

A: I would recommend it. I think it has great advantages.

VI-32.Q: (Directed to the paper of Mr. V.C. Patel)
How do U.S. banks, in case of term loans, ensure continuity of good management since in the U.S. they do not have our system of Managing Agents but only a General Manager?

A: Any change in the officers has to be made with the knowledge and consent of the bank. There is a clause in the Agreement that they will not change the management without the permission of the bank.

VI-33. Q: (Directed to the paper of Mr. P.K. Sen)
What do the Robert Morris Associates studies contain and what purpose do they serve?

A: These studies are compiled by the Robert Morris Associates on different types of trade and industry, including farming. They take financial statements submitted by various units in a particular industry and strike an average. So you get to know what the standard position of an industry is, and so compare with that standard. If you take the financial statement of a borrower and you find that there are large variations in certain items in the percentages, you can at once spot where this particular industry is running in a different direction than the other standard industries. In that way the banker is able to spot the weakness of that particular industry and advise the borrower on that particular point. Robert Morris Associates publish figures in respect to hundreds of different industries. The service is available to all members of the Robert Morris Associates.

VI-34. Q: (Directed to the paper of Mr. P.K. Sen)
The tendency in India is to show a certain reluctance in making balance-sheets available to any public body. Will it, therefore, not be extremely difficult to provide an effective service in India similar to the Robert Morris Associates studies?

A: It is incumbent on every company both public and private to publish its annual audited balance-sheet which is sent to the shareholders as well as to the Registrar of Comapnies. So in the case of companies there is no possibility of evasion of this law. There is a penalty for not publishing the balance-sheet. But as far as private individuals or firms are concerned there is nothing legally binding on them to publish their assets and liabilities statements. We can educate people and make them understand the usefulness of preparing balance-sheet and submitting them to the bank. This is a way in which banks in India can assist their borrowers.

VI-35. Q: (Directed to the paper of Mr. R.V. Pandit)
If instalments on Instalment Loans, Personal Loans or other types of loans fall in arrears, the bank endeavors to "educate" the borrower. How is this education brought about?

A: When an instalment due on the loan is not paid, it is usual for the loaning officer to write a polite letter to the borrower reminding him that it is obligatory to pay the instalment, and that probably he has overlooked it. Then, after a week or so, if payment is still not forthcoming, he sends a slightly stronger letter drawing attention to the irregularity and stating that they do not like to have any unpleasantness with the borrower if they can help it. So they try their best either to ring him up or to write a letter to him so that he does not take offence and at the same time rectify an ommission.

VI-36. Q: (Directed to the paper of Mr. R.V. Pandit)
In monthly statements information is given on aging of the receivables and aging of the payables. What is meant by these two terms?

A: When an industrialist sells his wares to his customers in the United States he usually quotes one price for cash payment and another for payment after 30 days, 60 days, or 90 days. These appear in his books as "receivables". Naturally, when people are reluctant to pay at short maturity, it is an indication that either he is not able to sell the wares to his customers or there is something wrong with them or that he has not chosen the proper customer. So the aging of the receivables shows how much of these amounts outstanding are payable after 15 days, how much after 30 days, how much after 60 days and 90 days. Similarly, in the case of "payables", when the man purchases raw material he takes it on credit and gives notes which mature after 15 day 30 days, 45 days, 60 days or 90 days or more. In this way you get to know his financial position. These facts give an indication of his actual outstandings and his payables If a company is not paying its dues in proper time, there is something wrong with the financial position and that gives sufficient warning to the banker to find out what the reasons are, and if there is something really wrong he takes appropriate steps at the right time.

VI-37. Q: (Directed to the paper of Mr. R.V. Pandit)
In view of the large number of long-term loans, does the nature of deposits in America differ much from those in India? Are there a lot of long-term desposits in America, and are there fixed deposits for long periods?

A: Most of the lending that is done by banks in India is on a demand basis, which of course does not mean that repayment is called upon immediately. The understanding is always were between the banker and the borrower that so long as they honour all the other convenants of the cash credit agreement, the money will not be called up arbitrarily. In this way banks furnish financing on a sort of permanent basis and it goes on for years and years. In the case of some industries, there is no fixed final repayment at all. They just go on being renewed after every half year or a year and in that way they are virtually long-term loans although legally they are short-term or demand loans. On the question of deposits in American banks, the people deposit money and withdraw it at any time. Information is usually so much spread round that a banker will know if somebody puts in a substantial amount of money, and he has a pretty good idea as to how long that money will be there. The relationship between the bankers and the industrialists normally is pretty good and they will tell each other what each has in mind. Deposits are not for any set term. They are open deposits, subject to withdrawal at any time.

VI-36. Q: (Directed to the Panel)
In U.S.A. the Savings Bank furnishes the small saver with a service which is pernaps not available to him through commercial banks. Does the panel suggest similar instituions for India? Would the Government of India, through the Post Office, compete for the deposits from the poor and middle classes? Does the Government of the United States also operate similar instituions as the Post Office Saving Banks in India for the collection of small deposits, only giving a better service?

A: The postal saving system in the United States is now a days a very small source of savings. Interest is about 2%. Each saving bank pays 3% and sometimes even more. There is hardly any competition between savings banks and commercial banks. It would not be accurate to say that only small people go to savings banks. People with substantial money having deposits of $10,000 also use the savings banks. So there is no competition between the U.S. Government and the savings banks, and there would be no need for competition like the Indian Government saving system, postal savings, and private savings banks. There are savings and loans associations in the United States. Though they are called saving association, their activities are of the nature of building societies in the United Kingdom. But even so, their depositors really are shareholders.

VI-39. Q: (Directed to the paper of Mr. S.K. Pandya)
Is the attitude of the Federal Reserve Bank, when inspecting American commercial banks, different from the attitude of the Reserve Bank of India in carrying out a similar type of inspection?

A: The quality of the inspection is as thorough as that conducted in India by the Reserve Bank. The question of attitude depends very much on the response.

VII-40. Q: (Directed to the paper of Mr. S.K. Pandya)
In the United States only the National banks can subscribe to the stock of 12 Federal Reserve Banks and six out of nine directors of the boards of each Federal Reserve Bank are elected by those particular banks. In our country the Reserve Bank is an entirely government-owned institution and the member banks neither own stock nor do they have any members on the Board. Would it be beneficial if an advisory body of bankers were constituted who could be consulted by the Reserve Bank from time to time, and would this lead to smoother working of the banking structure as such?

A: Anything that helps the economy of India and promotes progress, and gets people together for a common purpose, is good.

VII-41. Q: (Directed to the paper of Mr. S. K. Pandya)
Though the Federal Reserve Bank has various regulatory and control powers, there is evidently nothing like the power of the Reserve Bank here to control the advances of the banks taken together or of an individual bank. Neither does the Federal Reserve Bank ever have the power to limit advances against particular types of securities as the Reserve Bank of India has by issuing directives. Is this power not necessary? Or are the techniques adequate?

A: The Federal Reserve certainly controls advances collectively and individually. They do this very much on the same lines and with the same intentions, and the Federal Reserve carries out a very thorough inspection not only regarding loans but the loaning powers of the officers. They are quite thorough and quite in keeping with what the Reserve Bank does over here. Inspection of member banks is both exhaustive and thorough. The instruments of monetary and banking control are very effective from the point of view of restraining the advancing power of the banking system in general. Three items of control are the discount rate, the statutory reserve, and the open market operation. These three together are used either alone on in combination in order to get a specific result. The objectives of short-term regulations are rather different in the United States than here. Their inter-state policy and control over reserves is so great that automatically they can bring about an overall restriction or expansion of credit through these instruments much quicker than it can be affected under Indian conditions. When the Federal Reserve inspects the individual bank, they also examine the term loans made by individual banks and in deciding whether certain loans can be approved by them or not they take into account the latest position furnished by the bank concerned as to their progress or to the method of repayment. And then on the basis of performance of the loan account, they consider whether it should be approved or not They have a very flexible approach to the whole problem and so long as the performance of their account is satisfactory they approve the term loans. The position in India is much different from the position in the United States where perhaps the credit to government may not, from the point of view of credit by the banking system to government, be as large as credit to the private sector. The position in India is in the reverse direction. But from the point of view of maintaining stability and development there naturally should be integration of both credit to government and credit to the private sector.

VII-42. Q: (Directed to the paper of Mr. S. K. Pandya)
Is the board of directors of the Federal Reserve Bank in the U. S. independent of the Board of Governors of the Federal Reserve System, or is it merely a body to execute the policies of the Board of Governors?

A: The local Federal Reserve Bank has nine directors. Six are elected by the member banks. Three are nominated by the Federal Reserve board, and for the local Federal Reserve Banks the president and the vice-president must be amongst the three and not amongst the six. In regard to the responsibilities of the three instruments of Federal Reserve action, the discount rate is set by the local Federal Reserve Bank subject to approval by the board and there have been occasions when you find that for Atlanta it may be 3-1/4% whereas in New York it was 3%. Such variations in the discount rate arise as a result of variations in local conditions. So in the matter of fixation of the discount rate the power is exercised by the local Federal Reserve Bank. In regard to the open market operations they have adopted a committee system. There are about 12 members of the open market committee, of which five are members of the board of governors and seven are from the 12 Federal Reserve Banks. The president of the Federal Reserve Bank is a member of the open market committee. Of the 12, only 7 are members at a time and the other five are asked to attend the meeting although they may not be entitled to vote. So open market policy is decided on the basis of the recommendation of these people.

VIII-43. Q: (Directed to the paper of Mr. P. V. Gandhi)
Consumer goods are in short supply in India. By extending consumer credit and placing purchasing power in the hands of people who have little to save, would not the banks push prices up and thus strengthen an inflationary trend? Is the time appropriate for banks launching upon such schemes? The DENA Bank in India has started a scheme of consumer credits and personal loans. What are the salient features of this scheme and has it been successful?

A: The primary objective of the First Five Year Plan was to attain a state of equilibrium in the country through emphasis on agricultural production. In the Second Five Year Plan the emphasis was on intensive production of heavy industries for supplying materials to the small scale

industries. In the Third Five Year Plan there is every likelihood that having attained production capacity in the heavy industries, the emphasis is likely to be on small-scale industries. Therefore, the time has come, when we are on the threshhold of the new plan, that we should prepare ourselves. The banks should prepare themselves to finance the credit needs and thus help the consumers as well as the industries and stimulate production by consumer credit. The banks themselves are not very experienced in consumer credit nor are the people credit-worthy. It is up to the banks now to reorientate their attitude and make people credit worthy and prepare them to meet the needs of industry in the Third Five Year Plan. This is the right time for starting consumer credit loans.

As regards the personal loan scheme, started by DENA Bank, it is to help individuals and is based on the integrity and dependability of the individual. Normally no security is required. It is a personal loan. The limits are fixed from Rs. 500 to Rs. 5, 000 for the present and assist the individual or small business to buy whatever is required for their personal needs or for their business. The instalments for payment are from six months to 24 months. The discount rate is 5-1/2% for loans repayable in 12 months and 6% for loans repayable beyond 12 months and upto 24 months. There is also an added protection to the borrower that in the case of the death of the borrower, the outstanding amount is written off and no claim is made on the dependents. The idea is to increase the standard of living of the people.

VIII-44. Q: (Directed to the paper of Mr. P. V. Gandhi)
In the light of the fact that the Indian civil law regarding recovery of personal loans is extremely complicated, will this constitute a serious handicap to the successful implementation of the consumer credit scheme?

A: There are difficulties, but the banks if they want to re-orientate their attitude and assist the country in development, have to face the difficulties and introduce these schemes. These legal questions will be solved, and there should be quick legislation and decision on such matters. The conditions when consumer credit was introduced in the United States and here are different. Consumer credit in the U. S. was an off-shoot of depression. There is not a likelihood of a depression here. But there is every likelihood of a boosting up of our requirements. The banks should boost consumer goods industries, and that is why consumer credit is necessary here. It is not necessary for us to wait for a depression to introduce consumer credit.

VIII-45. Q: (Directed to the paper of Mr. P. V. Gandhi)
Loans are covered by insurance which extinguishes the liability of the borrower in the unfortunate event of death. How does DENA Bank underwrites such risks?

A: In the United States, the banks cannot keep the insurance themselves. They have to place it with the insurance companies. In England the Midland Bank introduced this scheme and they keep the insurance themselves. When we started the scheme we did approach the Life Insurance Corporation, which is the only body which can insure against death, and we have been given by them a very good group insurance scheme. But certain terms have been rather stiff, particulary in regard to the rates of premium above the age of 40. We are still carrying on negoations as to the terms. In the meantime the bank is keeping the insurance to itself, setting out a part of the discount and keeping it in a fond from where such eventaulities would be met. We are merely providing for a contingency. We do not pay the claim to the insurer, we just write off the loans without going into legal formalities.

Report on the Operations of the Refinance Corporation for Industry Private Ltd.

I must first of all thank the T. C. M. Authorities for the opportunity they have given me to give a brief report to you today on the operations of the Refinance Corporation for Industry Private Ltd. Perhaps, I may begin by making a reference to the Agricultural Commodities Agreement which was signed on behalf of the Governments of India and United States in August 1956. One of the clauses in this Agreement contained a provision to the effect that the equivalent in rupees of a sum of $55 million be earmarked for relending to private enterprise in India through the medium of established banking facilities. In pursuance of this provision, discussions took place between the representatives of the two Governments as to the mechanism to be devised for the purpose of channelling these funds in order that they may be put to the most effective use. Eventually, it was agreed that a Refinance Corporation should be set up as a limited liability company and that it should be the agency through which the counterpart funds of about Rs. 26 crores (i. e. equivalent of $ 55 million) should be relent for the use of private enterprise in India. It was similarly agreed between the two Governments that the Refinance Corporation should have an issued capital of Rs. 12-1/2 crores and that this should be subscribed by the Reserve Bank of India, Life Insurance Corporation of India, State Bank of India and fourteen other scheduled banks selected on the basis of the size of their Indian resources. Out of the issued capital, the Reserve Bank was required to take up Rs. 5 crores, the Life Insurance Corporation and State Bank, Rs. 2-1/2 crores each and the remaining 14 banks, Rs. 2-1/2 crores between themselves. Actually, in the process of working out the details, the allocation as between the State Bank of India and the other participating banks has undergone a small change in that the State Bank has taken up Rs. 2. 3 crores and the other banks Rs. 2. 7 crores.

2. I may here mention that all the 15 banks including the State Bank accepted the scheme relating to the establishment of the Refinance Corporation in April 1957 and by August of the same year, all the preliminaries requisite for the setting up of the institution such as, for instance, drawing up the Memorandum and Articles of Association were completed. However, owing to some technical reason, the registration of the Corporation was delayed by a few months. The Corporation was actually registered as a private limited company on the 5th June 1958 with a Board of 7 directors including the Governor, Reserve Bank of India, as Chairman of the Board. One of the Deputy Governors nominated by the Reserve Bank, the Chairman of Life Insurance Corporation and the Chairman of the State Bank of India as well as 3 representatives of scheduled banks are the other directors of the Corporation.

3. The Corporation took about two to three months initially before it got ready to receive proposals for the grant of refinance to the member banks. The intervening period was utilised for the receipt of applications and allotment of shares, entering into an agreement with the Government of India for drawing loans up to the extent of Rs. 26 crores representing the counterpart funds and settling the procedure for the grant of refinancing facilities. The Corporation actually started receiving proposals under the scheme from about September 1958 and so far, it has sanctioned refinancing facilities to the extent of Rs. 2. 43 crores, of which Rs. 50 lakhs have been disbursed till date. The industries to which loans have been sanctioned are ferro-maganese, cotton textiles, cement, pharmaceuticals and pharmaceutical chemicals, engineering and electrical equipment.

4. As you know, the Refinance Corporation is not intended to provide assistance to either the large industries or the small-scale industries. Its purpose is to finance medium-sized industrial units so as to facilitate increased production in the private sector. The industry should be one of those listed for development in the second five year plan and such other plans as may succeed it. The loans given by member banks must be on a medium term basis i. e. for a period of 3 to 7 years and the maximum amount of loan to be given to any one unit under the scheme is Rs. 50 lakhs. As a working definition, member banks have been advised that units whose paid-up capital and reserves (excluding reserves for payment of taxes and normal depreciation reserves whether designated as reserves or otherwise) do not exceed Rs. 2-1/2 crores and are not less than Rs. 5 lakhs should be regarded as medium sized for the purpose of provision of facilities under the scheme. The essential principle on which the scheme has been framed is that the member banks should grant the loan initially on their own judgment and initiative subject only to compliance with certain policy conditions laid down by the Corporation, the role of the Corporation being limited to the provision of refinancing facilities in cases where the prescribed conditions are satisfied and the units to which assistance is given are considered worthy of such assistance in the industries to which they belong. You will, therefore, appreciate that the member banks bear the risks arising from the grant of medium-term loans under the scheme and this being so, the Corporation does not ordinarily concern itself with the creditworthiness of the units to which loans are given or the sufficiency of security taken in such cases.

5. I would like, with your permission, to digress a bit at this stage and say something of the role of the Corporation. I have earlier mentioned to you that the immediate occasion for the establishment of the Corporation was the necessity to devise a suitable institutional frame-work for the purpose of channelling the counterpart funds in accordance with the principles agreed to by both the Governments. I have also mentioned to you that the total resources which will be available to the Corporation under the existing arrangements would be of the order of Rs. 38-1/2 crores, made up of Rs. 26 crores counterpart funds and Rs. 12-1/2 crores representing the issued capital of the Corporation. We have allocated this amount in the form of quotas or refinancing limits to the 15 member banks. The State Bank gets a quota of Rs. 5 crores while in respect of the other 14 banks the quotas vary from a minimum of Rs. 1.25 crores to a maximum of Rs. 3 crores depending on the size of the bank concerned. It therefore follows that the member banks are free to utilise the full extent of their quotas by putting up suitable proposals to the Corporation. This will provide them with very useful experience in the techniques of formal medium-term lending and also give them an opportunity to assess the risks involved in this type of operation as distinguished from the risks of commercial short-term lending with which the banks are already familiar. It is our hope that our member banks will gradually be willing to accept medium-term lending for the purpose of industrial expansion as one of their legitimate functions and be prepared to utilise a part of their own resources for extending this type of loans. Indeed, such a stage may be reached when the resources presently available to the Corporation are fully used up and the legitimate requirements of the constituents of member banks which are sound industrial units for medium term loans for purchase of machinery, equipment, etc. have to be met. For the present, I would like to particularly spotlight the fact that the setting up of the Corporation marks the first attempt in India in the direction of assisting and encouraging some of the larger scheduled banks to entertain proposals for assistance on a formal medium term basis. In this context, you will appreciate that the offer of the P. L. 480 counterpart funds for this purpose has been, to use my Chairman's words "a timely and valuable accessory for reorientation of the operations of the Indian banking system in the direction of greater service to industry"

6. The Chairman of the Corporation, Shri H. V. R. Iengar, Governor of the Reserve Bank of India, had occasion recently to make a comprehensive review of the operations of the Corporation in his speech to the shareholders at the first Annual General Meeting held on the 23rd March 1959. With your permission, I would like to read to you the following extracts from his speech indicating the reasons for the somewhat unimpressive record of the Corporation so far and the prospects available to it in the years to come. This is what Shri Iengar said:

"As a beginning, the progress made by the Company, though modest, cannot be regarded as unsatisfactory. Nevertheless, there is no gainsaying the fact that it belies the high hopes entertained when the first discussions took place in regard to its setting up some two and a half years ago. I recall that it was then thought that the funds available to the Company would be used up much more rapidly than has, in fact, proved to be the case so far. It seems desirable to examine the significance of the change that has taken place since then in the investment situation. Although, the Corporation is only concerned with medium-scale industries, the change that has taken place would appear to apply to industry generally.

It may be useful, in analysing recent changes, to go back to the year 1951 when the First Plan was started. In that year, the rate of formation of gross fixed assets estimated for the private sector of industry was 5.9 per cent. It rose by 1955 to 10.8 per cent., the average for the First Plan period as a whole being 8.3 per cent. In 1956, the figure rose to 14.3 per cent. and in 1957 to 16.8 per cent. Some of the statistics on which these conclusions are based have been published from time to time in the Reserve Bank bulletins, the latest analysis being in the issue for February 1959. The rate of growth in the years 1955, 1956 and 1957 was phenomenal in Indian economic history. But all indications are, though full data are not yet available, that in 1958 there was a scaling down of investment activity. There was a marked decline in private imports of capital equipment. The consents for capital issues declined; so did the licences granted under the industries (Development & Regulation) Act for schemes of any magnitude. This decline, which happened to coincide with the initial period of working of our Company, occured primarily because of the growing difficulties in the availability of foreign exchange, and to some extent also because, in some sectors of industry, there was a slackening of demand.

The present decline in the rate of growth of industrial activity seems, however, by no means indicative of future trends in the private sector of our economy. The rate of growth, particularly in 1956 and 1957, was so high that a continuance of the pace together with the rate of investment in the public sector on schemes that had already been initiated would have imposed a tremendous strain on the economy and led to severe inflationery pressures. What we are

witnessing is a certain imbalance in the rate of progress during a five year period; if it could have been done, it would have been desirable to achieve better phasing. A sustained, though moderate, rate of growth is preferable to waves of investment activity followed by periods of stagnation.

On all the indications now available, both in regard to the availability of external resources and the functioning of the economy domestically, it would seem unrealistic to assume that during the remainder of the Second Plan period, the scale of industrial investment could be anything like what it was in 1956 and in 1957. On the other hand, there is no reason to suppose that it should come to a halt. The main limiting factor has been the availability of foreign exchange. It does appear that avenues for this for new enterprises or expansion of existing enterprises have by no means been used up. The Industrial Credit and Investment Corporation of India (I. C. I. C. I.) for instance, has not yet exhausted its line of credit in foreign currencies provided by the International Bank for Reconstruction and Development. Moreover, it has been recently stated by the Chairman of the I. C. I. C. I. that negotiations for a new line of credit are progressing satisfactorily. Discussions have been initiated between the I. C. I. C. I. and ourselves for a closer working relationship so that the resources available between us may be more effectively utilised for the benefit of the country's economy. Discussions have also been initiated with the International Finance Corporation and the Commonwealth Development Finance Company with a view to negotiating, in particular cases, for provision of the necessary foreign exchange for schemes for which the rupee finance, in part or wholly, would be provided by the Refinance Corporation. It is my hope that industrial development in the private sector will thus be kept up during the remainder of the Second Plan although at a necessarily reduced tempo; and that thereafter, under the steady stimulus of succeeding development Plans, it will be maintained at a high level. That would seem, in the light of Government's declared policy, the necessary consequence of the completion of basic projects in the public sector such as the new steel plants. This will mean, on the one hand, that the skills and the ability to take risks which exist in large measure in our country, as has been shown in 1956 and 1957, will be harnessed to the country's interest and, on the other, that such a development will take place within the broad framework and objectives of the Plan."

7. I may now say something about the accounting side of our operations for the period 5th June 1958 to 31st December 1956. During this period which continues to be the position even now, our resources consisted of a paid-up capital of Rs. 2 1/2 crores as against the issued capital of Rs. 12-1/2 crores and a loan from Central Government of Rs. 5 crores from the limit of Rs. 26 crores up to which we could draw as and when we feel the need for it. This makes Rs. 7-1/2 crores in all. We had invested practically all this amount in the form of call or short-term deposits with our member banks and thus the interest earned on such deposits constituted the only source of income during the above period. Out of this income, we have been able to pay interest to Government on their loan of Rs. 5 crores at only 1% per annum whereas the normal rate payable to them is 4%. This has enabled us to pay a dividend, after providing for taxation, of 4% to our shareholders. Referring to this aspect, the Chairman of the Corporation has observed in his speech to the shareholders recently as follows

> "this was perhaps a necessary incentive to banks for operating in what is virtually a new field, but it is an incentive of large value and we are grateful to the Government of India for agreeing to it".

Closing remarks by Mr. Howard E. Houston, Director
U. S. Technical Cooperation Mission to India

The time is drawing near when we must adjourn. I would first of all like to thank Mr. G. A. Burgers from the TCM staff as Investment Advisor for making all these arrangements, which I think have been very well done. But principally I would like to thank all of you here present for your willingness to come together to spend these two days in a friendly and co-operative spirit of inquiring and looking for more information as well as exchanging ideas for better ways to do things. It has been a most informative and interesting meeting. I personally have had a very liberal two-day education! I know I have enjoyed it. I hope the same has been true of the rest of you.

Closing remarks by Mr. T. K. Ramasubramaniam,
General Manager, Refinance Corporation for
Industry Private Limited

Before the session comes to a close, may I be permitted, Mr. Chairman, to say a few words on behalf of myself and my colleagues. We have greatly appreciated the opportunity you have give us to meet together again under your auspices and the very useful discussions which we have had on major problems of banking for the last two days. I would also take this opportunity to express our deep sense of gratitude to the U. S. Technical Cooperation Mission to India and the International Cooperation Administration in Washington for sponsoring our visit to the United States and giving us facilities to come into contact with leading bankers, not only in New York but in various other centres, including smaller towns, in the States. Our stay in the States was not only pleasant throughout but also highly useful since we were afforded every opportunity to familiarise ourselves with the practices and techniques observed by banks and other financial institutions there in respect of medium-term lending to industries. This visit, indeed, has been an important milestone in our lives and we shall never forget the many friendships we made in the States and we hope that the contacts thus established will be a source of strength to Indian banking in the years to come. Thank you very much again.

Closing remarks by Mr. S. T. Sadasivan, Member of the
Board of Directors of the Refinance Corporation and
General Manager of the United Commercial Bank.

On behalf of those present here today, I wish to convey to you Sir, an expression of our thanks for the able manner in which you have conducted the proceedings of this meeting. We esteem it a great privilege to have had H. E. Morarji Desai and His Excellency the Ambassador for the United States at the opening session of the conference to inaugurate the meeting.

The idea of sending a delegation of Indian bankers to the United States to get acquainted with the latest methods of handling medium term loans to industry, is an excellent one, because we feel that in the changing circumstances of industrialization of India, banking methods should be geared up to the changing needs of the situation. As I had already remarked in the course of the discussion, it is incumbent on all bankers present here to make the operations of the Refinance Corporation a success, so that we might utilize within a comparatively short time the resources so liberally placed at the disposal of the Corporation by the International Cooperation Administration, and thereafter approach you, Sir, again for a further allocation out of the PL 480 funds. We are also grateful to you, Sir, for having made it possible for a second delegation of bankers to visit your country, again this year, to familiarize themselves with American banking methods.

In conclusion, I thank you once again, Sir, for having spared so much of your valuable time to preside over our deliberations.

Program for a two-day Debriefing Seminar for the
16 Members of the Banking and Investment Team.

FIRST DAY
April 20.

09.45	Arrival of participants and guests at Vigyan Bhavan (King Edward Road) Conference Room 'B'.
10.00	Introduction by Ambassador Ellsworth Bunker and H. E. Morarji Desai Finance Minister.
10.05-) 10.35)	Debriefing Seminar, chaired by the TCM Director, Mr. Houston, in which each of the sixteen Banking and Investment participants will analyse a certain phase of U.S. Banking, keeping in mind the three main objectives of this Seminar; a) to explain U. S. Banking operations, b) to evaluate U. S. Banking practices in the light

of those commonly followed by Indian banks, and c) to voice suggestions on new thoughts and ideas, developed as a result of the study tour, for further consideration and possible application in India.

THE POSITION OF U.S. BANKING IN INDUSTRY -
5 Minute speeches by four banking participants:

1) The philosophy, based on the change in our modern economy, which has led to the switch from purely commercial credit banking to industrial development banking.

2) Bank participation in promotion of projects for regional industrial development

3) Government financing agencies and their cooperation with private banks.

4) Joint loans, in which a number of banks participate.

10.35-)
11.20) Questions and answers

11.20 Coffee break

11.45-) MEDIUM TERM FINANCING FOR INDUSTRY -
12.15) 5 Minute speeches by four banking participants:

5) Advertising and business promotional activities by U.S. Banks

6) Procedures and bank assistance to client in documentation of loan applications.

7) Investigation of loan applications.

8) Credit investigation by banks and inter-bank exchange of credit information.

12.15-)
13.00) Questions and answers

13.00 Lunch at Mr. Houston's residence - 11 Akbar Road.

14.45 Return to Vigyan Bhavan in TCM transportation.

15.00-) MEDIUM TERM FINANCING FOR INDUSTRY -
15.30) 5 Minute speeches by four banking participants:

9) Loan negotiations, protective covenants and qualification of types of loan collateral.

10) Technical and other services rendered by banks to their clients in industry.

11) Follow-up by lending banks once a loan has been granted.

12) Statistical and other pertinent information available to banks. (American Bankers Association/U.S. Government Publications).

15.30-)
16-15) Questions and answers.

19.00-)
21.00) Refreshments at Mr. Burgers' residence - 100 Sundar Nagar.

SECOND DAY
April 21.

10.00 Arrival of participants and guests at the Vigyan Bhavan Conference Room 'B'.

10.05-) GENERAL OBSERVATIONS ON U.S. BANKING -
10.35) 5 Minute speeches by four banking participants:

13) The role of the Federal Reserve Bank in U.S. banking.

14) Bank Management, branch bank/head office relationship.

15) Credit investigation agencies. (Dun & Bradstreet, etc.)

16) Consumer and personal loans.

10.35-) Questions and answers
11.30)

11.30 Coffee break.

12.00-) Report on the operations of the Refinance Corporation for Industry Private
13.00) Limited by its General Manager, Mr. T.K. Ramasubramaniam,

Discussion on operational and other problems of the Corporation, and future developments.

13.00 Lunch at Ambassador Bunker's residence - 17 Ratendone Road

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LIST OF SIXTEEN SPEAKERS AND TITLES OF PAPER PRESENTED BY THEM

1.	Mr. K.N.R. Ramanujam Dept. of Research & Statistics Reserve Bank of India.	The Philosophy, based on the change in our modern economy, which has led to the switch from purely commercial credit banking to industrial development banking.
2.	Mr. Ram Rakha Development Officer State Bank of India	Bank participation in promotion of projects for regional industrial development.
3.	Mr. T.K. Ramasubramaniam Reserve Bank of India General Manager, Refinance Corporation for Industry Private Limited.	Government Financing agencies and their co-operation with private banks.
4.	Mr. V.C. Patel Chief Accountant Central Bank of India Ltd.	Joint loans, in which a number of banks participate.
5.	Mr. A.L. Sathappan Staff Officer Indian Bank Limited	Advertising and business promotional activities by U.S. Banks.
6.	Mr. R.P. Chopra Controller of Advances Pubjab National Bank Ltd.	Procedures and bank assistance to clients in documentation of loan applications.
7.	Mr. S.V. Chandavarkar Asst. Inspector, Staff Officer State Bank of India	Investigation of loan applications.
8.	Mr. M.G. Parikh Manager Bank of Baroda Ltd.	Credit investigation by banks and inter-bank exchange of credit information.

9.	Mr. B.N. Mehta Legal Division Reserve Bank of India.	Loan negotiations, protective covenants and qualification of types of loan collateral.
10.	Mr. K.D. Shandilya Officer in Charge Inspection Department State Bank of India.	Technical and other services rendered by banks to their clients in Industry.
11.	Mr. R.V. Pandit State Bank of India	Follow-up by lending banks once a loan has been granted.
12.	Mr. P.K. Sen Supdt. of Branches United Bank of India Ltd.	Statistical and other pertinent information available to banks. (American Bankers Association/ U.S. Government publications.)
13.	Mr. S.K. Pandya Asst. General Manager United Commercial Bank Ltd.	The role of the Federal Reserve Bank in U.S. banking.
14.	Mr. C.S. Venkat Rao Supdt., Advances & Investments State Bank of Hyderabad.	Bank management, branch bank/head office relationship.
15.	Mr. K.S Chaturvedi Senior Assistant Bank of India Ltd.	Credit investigation agencies. (Dun & Bradstreet, etc.
16.	Mr. P.V. Gandhi Managing Director Devkaran Nanjee Banking Co. Ltd.	Consumer and personal loans.

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* GOI Officials invited to attend the Banking & Investment Seminar.

** Member of the Board of Directors of the Refinance Corporation invited to attend the Banking & Investment Seminar.

@ Banking & Investment Team Participants.

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WALKER, Mr. William P. - TCM/IND

ZAGORIN, Mr. Bernard, Financial Attache, Embassy.